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(The opinions expressed in articles in The Canadian Chartered Accountant are the opinions of the writers of the articles and are not necessarily endorsed by the Association.)

Editorial Comment

They Also Serve

Never before in the history of accounting has there been so much to interest the public accountant in the practice of his profession as there is today. The ever-changing income tax laws, the excess profits tax, and now wage and price controls present a kaleidoscope of problems for the accountant and his clients. That, as citizens, we should support the government in their every effort to organize for the common task goes without saying. No less as accountants do we owe the government our support. Everyone is not called on to take a direct part in the combative or administrative aspects of the war effort but in the daily practice of his profession the accountant can do much to make the task of government easier.

In the matter of taxation the distinction between evasion and avoidance is often a narrow one. Naturally the taxpayer does not wish to pay more than the law requires of him. On the other hand it is not for the professional accountant to conceive ingenious plans for reducing taxation which, in many cases, do no more than postpone the day of reckoning. In the field of wage and price controls the accountant can also be helpful. The chairman of the Wartime Prices and Trade Board has said that he knows of fifty

reasons why price control will not work; the accountant and his clients can probably suggest many more. Every practitioner has a few clients who are convinced that their particular business does not lend itself to such checks and controls. Here is an opportunity to get behind our administrators and through sound advice, based on an appreciation of the needs of the moment, add our contribution to the common good.

Dropping of Cents

From the days of 1939 when uniform examinations of the provincial Institutes became a fact, the board of examiners-in-chief have been gradually eliminating cents from all examination papers. They succeeded in attaining that end in the June 1941 examinations and thereby established a precedent for subsequent writing periods. The presence of a decimal point and two figures (mostly noughts) at the end of a set of figures is, we hope, gone forever from the examination papers of our profession.

The change means more than the elimination of useless figures. It conserves space in columnar work, reduces the possibilities of clerical errors so easily made under the stress of the examination room and, most important of all, it affords extra time to the candidate for committing to his answer paper the more significant matters of the examination. This change has been hailed with satisfaction. The desirability of extending the idea to a reduction in size of the hypothetical figures in examination papers is a matter for further consideration.

With the practice thus established in one direction where it will have its educational value for incoming members to our profession, and with visions of its application to wider fields, it was with satisfaction that we read the recent article on the dropping of cents written by F. A. Shink, comptroller of The Bethlehem Steel Corporation of America. In this the author goes the limit by advocating the elimination of cents from all accounting records. The article will be found instructive to all who have access to it.*

Have business executives in Canada considered dropping the cents from the published balance sheets of their com-

*"The Elimination of Cents from Accounting Records," pp. 400-403, *The Journal of Accountancy* (New York), November 1941.

panies? A reference to a few financial statements, taken at random from our current file of annual reports of Canadian corporations, reveals the fact that in every case the figures for cents were retained. For instance, the railway operating revenues for the year 1940 of the *Canadian National Railway System* were shown as $247,527,224.81; the total assets of *Canada Packers Limited* at 31st March 1941 were $41,031,943.48; the inventories at 31st July 1941 of *Distillers Corporation-Seagrams Limited* were $50,116,290.61 and the inventories of merchandise and supplies of the *Dominion Textile Company, Limited* at 31st March 1941 were $3,385,843.12. Perhaps sweeping conclusions should not be drawn from these instances inasmuch as from the consolidated balance sheet at 31st August 1941 of *Hiram Walker-Gooderham & Worts Limited* and its wholly-owned subsidiaries, which has just arrived through the post, the figures for cents have been eliminated. Nevertheless these illustrations indicate the extent of the retention.

Impression of Exactness

Some time ago a prominent member of the profession, who had been called to give expert testimony in a bankrupt estate case, was explaining to the court the meaning or significance of that part of an auditor's report which states: "In our opinion the balance sheet correctly sets forth the financial condition of the company." The presiding judge, who tried again and again to get a categorical "yes" or "no" from the accountant to the questions of the court, received a mild shock when the witness said that he could not state without qualification that the balance sheet in question was correct and that had this balance sheet been made up to show a surplus of some thousands of dollars less he might still be able to state that it showed the correct position of the company.

In making such an observation the public accountant was expressing only what every corporation executive knows, namely, that the real value of the assets of a business is dependent on several factors, one of the most important being the earning capacity of the enterprise. Accounting is not an exact science. Values in the mercantile world are elusive things; an inspection of any day's stock market quotations bears evidence to that. Both the balance sheet and the income account are to a considerable extent the re-

flection of individual judgment—not haphazard judgment, but conclusions and opinions based on principles and on methods of compilation followed consistently from year to year.

In consequence in every financial statement there can be items of doubtful value. Who is capable of estimating to the cent the value at any moment of, for instance, the inventories of a company like *Canada Packers Limited?* their plant and machinery? their investments in subsidiary companies? Only a quack would be bold enough to lay claim to such an accomplishment.

The retention of cents in the published financial statements of companies is meaningless. More unfortunate still is the false impression of exactness received by the shareholder or the investor when cents are included. Exactness does not and cannot exist. Here are reasons enough for directors and executives to question the advisability of continuing further the publication of cents in the annual statements of Canadian companies.

The Writing of Dates

While on the subject of financial statements let us take a moment to consider the writing of dates. In the form and arrangement of the annual reports of companies there can be some measure of similarity but, since businesses vary, a uniform balance sheet or a hard-and-set form of income statement is not possible. Yet there can be consistency in some directions. If the reader were to inspect closely a score or more published balance sheets he would be lost in wonder at the variety of ways in which the date of the close of the fiscal year is shown. It is a case of fancy running wild. There is no reason for lack of uniformity here. What is more natural than writing the year end in the order of the day and the month and the year? Following that sequence the end of last year would appear as: 31st December 1941. No form could be neater: no method more logical. A section of business is using it. Let us encourage its adoption. And let us discourage therein any abbreviations of the month and the insertion of useless commas.

A New Year

It is said that there used to exist in Germany a beautiful custom on New Year's Day. Whatever may have been the quarrels or estrangements between relatives and others, on that day friendly visits were exchanged, kindly greetings extended and received, and former misunderstandings forgiven and forgotten.

What a change! Seeds of hate sown by a wicked man and his crafty conspirators have taken deep root. Mistrust between children and parents in Germany, impoverishment of mind and body for millions in the Nazi-dominated nations of Europe, and sorrows and sufferings so overwhelming that death becomes a welcome surcease—these are some of the annual harvests which have followed the day the Germans began their march in 1939.

One of the interesting pictures of the dark days of 1939 and 1940 was that line of crowned heads and statesmen who, driven by a tyrant temporarily from their homelands, found refuge in Britain. With hope and confidence they await the day when with the help of the British Commonwealth of Nations and the unstinting aid and armoured strength of the United States and our other allies the hosts of banditry will be overthrown and peace restored for all.

The new year of 1942 breaks upon a world in the throes of the greatest war and bloodshed known to mankind. Before final victory is won there will be darker days. Bereavements have already come to Canadian homes and many more will follow in the weeks and months before us. But that is one of the prices we shall have to pay for happier new years ahead. What more fitting message can we bring to those bereaved than the verses written by Sir Cecil Spring-Rice, British Ambassador to Washington during the last great war, after his son had been killed in action?

I Vow to Thee My Country!

I vow to thee, my country, all earthly things above,
Entire and whole and perfect, the service of my love,
The love that asks no question, the love that stands the test,
That lays upon the altar the dearest and the best;
The love that never falters, the love that pays the price,
The love that makes undaunted the final sacrifice.

And there's another country I've heard of long ago—
Most dear to them that love her, most great to them that
know—
We may not count her armies, we may not see her King,
Her fortress is a faithful heart, her pride is suffering;
And soul by soul and silently her shining bounds increase,
And her ways are ways of pleasantness and all her paths
are Peace.

The Late A. F. C. Ross

The profession throughout Canada learns with deep regret of the passing on 20th December at Montreal of one of Canada's outstanding members in the person of Alexander F. C. Ross. Up to a year ago Mr. Ross had been actively engaged in his professional duties when illness forced him to give up most of his work. The news of his death came just as this issue was going to press, and an obituary notice will be published in the February number.

The late Mr. Ross was admitted a member of the Society of Chartered Accountants of the Province of Quebec in 1893 and from the first became active in every interest of the Society. When it was evident that the profession of the chartered accountant must reach beyond provincial boundaries, Mr. Ross became one of the incorporators in 1902 of The Dominion Association of Chartered Accountants, and was its first Secretary. In 1907-08 the profession conferred upon him the highest honour it could bestow—President of the Dominion Association.

During his forty-eight years of membership Mr. Ross never allowed his interest in the profession to wane. He was a familiar figure at annual meetings and social gatherings of the membership and always had contributions to make to their thought and enjoyment. Indeed, for the older members of our profession today he has set an example of active participation that can be followed to the advantage of us all.

The sympathy of all members goes out to Mrs. Ross and the family.

INDUSTRIAL MANAGEMENTS' FISCAL POLICY IN THE CANADIAN WARTIME ECONOMY

By J. D. Campbell, Chartered Accountant, Kingston, Ontario

AS the relative importance of the modern industrial corporation has increased within the framework of the Canadian economy, the interest of the average layman has accordingly increased in the management policy operating within the industrial corporation. In our present war economy where the industrial corporation is playing such a significant part not only in an active war effort, but financially through very significant contributions in the form of sales, income, and excess profit taxes, the interest of the layman has been accordingly greatly amplified.

The extent to which this interest can be satisfied is of course dependent upon the nature and amount of the information which is available to the layman on management policy. Legally industrial corporations are required to place before the shareholders of Dominion incorporated companies annually a balance sheet, a general statement of income and expenditure, and a statement of surplus. Although these statements, with certain limitations, purport to disclose a current picture of the corporation's affairs, the average layman finds it quite difficult if not impossible to bring the information presented on the various statements into a composite picture which is at all intelligible.

From the comparative balance sheets which are available, taken as at the beginning and the end of a period, the individual increases and decreases in assets and equities can be calculated. The income statement for the period discloses in part the causes underlying these changes. If this information is combined with the balance sheet changes, a composite statement can be formed which is much more intelligible to the average layman. To this statement has been given the title "Application of Funds." The application of funds statement not only discloses a composite picture which is more understandable by the average layman in intelligently interpreting a given company's operations, but this statement may also be used significantly, particularly at present, in making available information which will

satisfy the lay interest in the question of management policy in Canada's wartime economy.

The customary items of information revealed on the application of funds statement are:

Sources of Funds

Net profit after depreciation
Depreciation charged against operations
Proceeds of new issue of securities.

Application of Funds

Cash dividends paid
Purchase of fixed assets
Investment in and advances to subsidiaries
Redemption of outstanding securities
Increase in working capital.

A comparison of the individual items appearing on the statement and the relationships existing between the respective items reveals interesting facts which act as indicators of general management policy.

In the study made of the fiscal policy of management in Canadian industry during the year 1940, an application of funds statement supplemented by a detailed analysis of the change in working capital was prepared for each of one hundred and eighteen companies. From this data an attempt was made to ascertain whether definite patterns of management policy could be developed. The data was prepared from the published statements of the corporations examined.

Depreciation Policy

When a concern purchases an asset whose term of service extends over the year period, management in presenting its results of operations for the given year period (income account) finds it necessary to defer a portion of the cost of the asset to a future period or periods. This process of deferring is necessary in presenting periodic income statements so that an accurate correlation of costs and revenue for a given period may be made. The question of the amount to be deferred (net value of the fixed asset) and the amount to be charged against revenue for the current period (depreciation charge) is purely technical.

As a fixed asset is used or is rendering services in the production of goods, the services rendered are in reality

being incorporated in the product which is being produced. When the product which is produced is sold, assuming that the selling price of the product is adequate to cover the costs of production including the services rendered by the fixed asset, such fixed asset service cost is realized in the form of funds which may be used by management.

The question arises as to what management is doing with the funds made available through the medium of depreciation charges. Management may either be using these funds to replace the services in regard to the fixed assets which have been incorporated in the product produced—which is theoretically the purpose of the depreciation provision from a financial standpoint—or if this is not considered necessary it may be utilizing such funds for various other purposes. As the term of service of a fixed asset customarily extends over several years, the demand for replacement funds will not arise as soon as the fixed asset is placed in service, and therefore for several years funds will be accumulating and will become available to management for use as they see fit. In a relatively new industry rather substantial funds are in this way being placed at the disposal of management which are not required for replacement purposes. To what use is management putting these funds when they are not required for replacement purposes?

It is impossible to ascertain from the published data of corporations, the extent to which expenditures made during a given period on fixed assets are replacement expenditures or expansion expenditures. This fact should be kept in mind in the following remarks made in respect to the corporations examined.

In a wartime economy the question of the use to which management puts the funds which have become available through the medium of depreciation charges, gathers added significance. When an attempt is being made to speed up the war effort, the main aim is to divert goods and services towards this goal, i.e. increased war effort. This may be done by an active diversion in this direction in the form of increased expenditures in those channels leading to a more progressive war effort. This diversion may be accomplished either through increased expenditures in industrial channels already directed toward war effort or by

retarding expenditures in other channels and diverting the effort so retarded into the channels of war effort. This latter may be accomplished either by changing the pattern of expenditures from non-essential war effort expenditures to essential war effort expenditures, i.e. diversion of industrial activity formerly used to produce consumption goods into activity designed for war effort, or by withholding expenditures which would be made in the ordinary course of business which if made would divert goods and services from the war effort. Management at the present time is thus faced with the responsibility of utilizing the funds which have come into their hands as a result of depreciation charges in such a way as to add the maximum to the war effort.

If additional fixed assets are purchased with the depreciation funds, whether they be replacements or part of an expansion programme, the question arises whether such expenditures will result in increasing or decreasing the net war effort. The alternative step would of course be the diversion of such expenditures, presumably through government channels, into expenditures in channels where such an increase in war effort may be accomplished. This latter may be obtained either by holding unexpended depreciation in the form of non-active cash balances or investments in government securities for the duration of the war.

Before examining the results of the study made for the one hundred and eighteen Canadian corporations for the year 1940 it would be well to recognize the difficulty which is encountered in an attempt to label any given expenditure made on the part of a concern as being essential or non-essential in the war effort. This is not only difficult for the analyst in dealing with the published statements, but equally so for the individual management due to the complex nature of the war economy. The positive steps taken by the Dominion government to control capital expenditures merely supports this deduction.

Table 1 indicates the methods utilized in the financing of expenditures made during the fiscal year 1940 by the Canadian corporations examined.

Table 1

Means Utilized by Industrial Concerns in Financing Fixed Asset Expenditures

(1940)

(in millions of dollars)
(118 companies)

	A[1] companies (24 companies)	*B*[2] companies (22 companies)	*C*[3] companies (72 companies)	*Total* (118 companies)
Fixed asset expenditures	$50	$17	$21	$88
Means of financing				
Depreciation provision	15	13	21[6]	49
Excess of net profits over cash dividends paid	15	4		19
Issue of securities	15[4]			15
Decrease in working capital	4[5]			4
Miscellaneous	1			1
	$50	$17	$21	$88

The fact that seventy-two corporations showed an unexpended depreciation provision for the fiscal year 1940 is an indication that funds which were set aside for replacement had in these cases been deferred by management from the purpose for which they were set aside. It is

[1]A companies—Canadian industrial corporations which utilized issues of securities and decreases of working capital in financing their fixed asset expenditures (See footnote to Table 4)

[2]B companies—Canadian industrial corporations whose 1940 fixed asset expenditures were covered by the depreciation provisions and retained earnings of these companies (See footnote Table 2)

[3]C companies—Canadian industrial corporations whose 1940 fixed asset expenditures were covered wholly by the depreciation provisions made (See footnote Table 2)

[4]Four companies concerned—Canadian Industries Limited, Aluminum Limited, Dominion Foundries and Steel Limited and Canadian Oil Companies Limited.

[5]Sixteen companies involved—In all cases but two the decrease in working capital was correlated with a decrease in the items of cash and investments.

[6]The excess provision for depreciation over the amounts expended on fixed assets amounted to $24 million.

interesting to note whether or not the funds represented by unexpended depreciation were diverted into channels of war effort.

Where a concern prior to the outbreak of the war had rather substantial amounts of unused productive capacity—unused plant and equipment—and where on the outbreak of war the unused productive capacity was diverted to war effort, the unexpended depreciation (assuming that it existed) may have contributed greatly to the war effort if the funds so provided were utilized by management in providing the working capital—accounts receivable and inventories—necessary to place the unused productive capacity into production.

In certain cases where the concern in question is unable to transform its productive equipment both used and unused to a productive war effort, the unexpended depreciation in this case would be diverted to channels of war effort either if the funds so provided were held as idle cash balances, invested in government securities, used to repay outstanding bank loans, or used to redeem long term indebtedness. The last instance would only apply providing the funds so distributed were diverted indirectly into war effort, i.e. in the purchase of government loans by the recipients of the funds received from the redemption. The assumption is made that bank policies as to loans will be so designed as to promote an increased war effort.

Although it is difficult to state definitely that certain increases in working capital were represented by increases or decreases in a particular item of the working capital, it was possible to make a rough segregation of the reflection of the increase as between an increase in cash and investments, a decrease in bank loans or an increase in inventories and receivables. It may be added that a decrease in cash and investments and an increase in inventories and receivables were classified as an increase in working capital reflected in a correlated increase in inventories and receivables.

Of the seventy-two companies in which it was mentioned that funds were made available from unexpended depreciation and the twenty-four companies where earnings were retained sufficient to more than finance the excess expenditures on fixed assets over depreciation provided, twenty-five corporations utilized such excess funds in increasing cash

and investments and reducing bank loans, and forty-one of the remainder used such funds to increase inventories and receivables. In the case of thirty-seven of the companies an amount of $9,564,000 of such funds retained were utilized to reduce outstanding funded indebtedness.

Corporate Profits

In addition to the item of depreciation, corporate profits represent the other main channel through which funds flow into the hands of management to be diverted to the uses which they deem advisable. Whereas depreciation in the case of the one hundred and eighteen companies examined provided management with funds to the extent of seventy-one million dollars, net profits provided one hundred and thirty-seven million dollars. Of these net profits distributions were made in the form of common dividends of seventy-seven million dollars and in the form of preferred dividends of eleven million dollars. This left retained earnings for the corporations studied of forty-nine million dollars. There were dividend distributions in excess of net profits in the case of only six corporations.

Similar to the situation re unexpended depreciation, management is called upon in the case of retained earnings to bear the responsibility of diverting these funds into those channels which will ultimately lead to a maximum war effort. Whether management by retaining earnings will divert such retained profits more efficiently to war effort than may be indirectly done through a distribution of such profits as dividends may be questioned. It does seem logical that in so far as the concern in question is operating on extensive war work the retention will in part ensure a diversion of funds to war effort as well as the removal of the possibility of increased consumer expenditures arising directly from such dividend disbursements.

As already indicated in twenty-four of the companies, the retained earnings were utilized by management in covering the excess expenditures made by management on fixed assets over the provision made for depreciation and in twenty-two of the corporations in partially covering the excess. Where unexpended depreciation existed the retained profits were merely reflected in either an increase in working capital, a reduction of funded indebtedness or a combination of the two.

Flow of Funds

Ninety-six of the one hundred and eighteen corporations examined, as set out previously, followed the lines of wholly financing fixed asset expansion either from depreciation provisions or from the combined depreciation provisions and retained earnings. Tables 2 and 3 present the "Application of Funds" and "Detailed Analysis of Changes in Working Capital" for these ninety-six companies.

Table 2

Application of Funds

Canadian industrial corporations whose fixed asset expansion policies were financed either from depreciation provisions or in combination with retained earnings.

1940

(000 omitted)

(96 companies)*

Source of Funds	
Net profit after provision for depreciation	$ 98,965
Depreciation charged to operations	58,385
Issue of common share capital	5,035
	$162,385
Application of Funds	
Cash dividends paid—common	$ 58,361
—preferred	7,265
Expenditures on fixed assets	38,298
Investment in subsidiaries	800
Redemption of—funded indebtedness	11,984
—preferred share capital	1,517
Increase in working capital	43,498
Miscellaneous	662
	$162,385

*Companies whose fixed asset expansion policy was financed wholly from depreciation provisions: General Steel Wares Limited, The Consolidated Mining and Smelting Company of Canada Limited, W. D. Beath & Son Limited, Eastern Steel Products Limited, Canadian Westinghouse Company Limited, Massey-Harris Company Limited, Canadian Fairbanks-Morse Company Limited, Canadian Vickers Limited, Con-

Table 3

Detailed Analysis of Changes in Working Capital
Canadian industrial corporations whose fixed asset expansion policies were financed either from depreciation provisions or in combination with retained earnings.

1940

(000 omitted)

(96 companies)

Cash	$14,254
Accounts and bills receivable	33,058
Inventories	62,165
Investments	7,755
Deferred charges	— 484
Bank loans	— 24,890
Accounts payable	— 20,379
Reserve for taxes	— 28,273
Miscellaneous accruals	292
	$43,498

solidated Bakeries of Canada Limited, The Robert Mitchell Co. Limited, Canadian Locomotive Company Limited, Canada Wire and Cable Company Limited, Sarnia Bridge Company Limited, Canadian Car and Foundry Company Limited, Disher Steel Construction Company Limited, Hamilton Bridge Company Limited, Page-Hersey Tubes Limited, Dominion Bridge Company Limited, Canada Foundries and Forgings Limited, Maple Leaf Milling Company Limited, N. Bawlf Grain Company Limited, United Grain Growers Limited, Federal Grain Limited, The Alberta Pacific Grain Company Limited, Western Grain Company Limited, Toronto Elevators Limited, Collingwood Terminals Limited, Reliance Grain Company Limited, Barker's Bread Company Limited, The British American Oil Company Limited, Canadian Cottons Limited, The Hamilton Cotton Company Limited, The Montreal Cottons Limited, The Wabasso Cotton Company Limited, Dominion Textile Company Limited, Dominion Woollens and Worsteds Limited, The Guelph Carpet and Worsteds Spinning Mills Limited, Belding-Corticelli Limited, The Regent Knitting Mills Limited, Acme Glove Works Limited, The Brantford Cordage Company Limited, The Canadian Converters Company Limited, Harding Carpets Limited, Tooke Bros. Limited, Woods Manufacturing Company Limited, Montreal Island Power Co. Limited, Standard Clay Products Limited, Canadian Dredge and Dock Co. Limited, Consolidated Paper Corporation Limited, United Distillers of Canada Limited, Western Breweries Limited, Melchers Distilleries Ltd., Canada and Dominion Sugar Company Limited, The Shawinigan Water & Power Company Limited, Abitibi Power and Paper Company Limited, The Crow's Nest Pass Coal Company Limited, Brompton Pulp and Paper Co. Limited, Asbestos Corporation Limited, National Sewer

An examination of Table 2 shows the pattern of management policy where there were funds provided from unexpended depreciation ($20 million) and retained earnings ($34 million) which funds were utilized in a net reduction in outstanding securities ($8 million) and an increase in working capital ($43 million). Whether or not the policy outlined above which was followed by management tends to divert goods and services towards the goal of an increased war effort cannot be definitely stated, but must be viewed in light of the considerations outlined previously in this article.

Table 3 is interesting in that it presents the pattern of the working capital increase. The relatively significant increases in accounts receivable and inventories should be noted together with the increase in the reserve for taxes.

Management policy in the remaining twenty-two of the one hundred and eighteen corporations examined followed a pattern of expansion which was financed only in part from retained earnings and depreciation provisions being supplemented in four cases by an issue of securities and in the remaining sixteen of the eighteen cases by a decrease in working capital. Tables 4 and 5 present the "Application of Funds" and "Detailed Analysis of Changes in Working Capital" for these twenty-two companies.

Pipe Co. Limited, Andean National Corp. Ltd., Donnacona Paper Company Limited, Provincial Paper Limited, Price Brothers & Company Limited, Dryden Paper Co. Ltd., Canadian Industrial Alcohol Company Limited, British Columbia Pulp and Paper Co. Ltd., Blue Ribbon Corporation Ltd., Canadian International Paper Company Limited, Canada Cement Company Limited, Burns & Co. Limited, Canada Packers Limited, Imperial Tobacco Company of Canada Limited.

Companies whose fixed asset expansion policy was financed in part from depreciation provisions and in part from retained earnings: St. Lawrence Flour Mills Company Limited, Cockshutt Plow Company Limited, Hayes Steel Products Limited, Niagara Wire Weaving Company Limited, Rogers-Majestic Corporation Limited, Canada Iron Foundries Limited, Dominion Steel and Coal Corporation Limited, Lake of the Woods Milling Company Limited, George Weston Limited, Imperial Oil Limited, McColl-Frontenac Oil Company Limited, Cosmos Imperial Mills Limited, Mercury Mills Limited, Penmans Limited, Biltmore Hats Limited, Goodyear Tire and Rubber Co. of Canada Limited, Easy Washing Machine Co. Limited, Canadian Breweries Limited, Union Gas Co. of Canada Limited, Distillers-Corporation Seagrams Ltd., Algoma Steel Corporation Limited, Dominion Stores Limited, British Columbia Packers Limited, United Steel Corporation Limited.

Table 4

Application of Funds

Canadian industrial corporations who utilized issues of securities and decreases in working capital in the financing of their fixed asset expansion policies.

1940

(000 omitted)

(22 companies)*

Source of Funds	
Net profit after provision for depreciation	$38,153
Depreciation charged to operations	15,073
Issue of—funded indebtedness	28,443
—common share capital	1,220
—preferred share capital	166
Sale of fixed assets	1,344
	$84,399
Application of Funds	
Cash dividends paid—common	$19,048
—preferred	3,713
Expenditures on fixed assets	49,941
Investment in and advances to subsidiaries	3,853
Increase in working capital	7,633
Miscellaneous	211
	$84,399

*Companies covered in the above table: Canadian Industries Limited, The Ogilvie Flour Mills Company Limited, Aluminum Limited, International Metal Industries Limited, National Steel Car Corporation Limited, Ford Motor Company of Canada Limited, MacKinnon Steel Corporation Ltd., The Steel Company of Canada Limited, Dominion Foundries and Steel Limited, Western Canada Flour Mills Company Limited, Canadian General Electric Company Limited, Canada Bread Company Limited, Canadian Bakeries Ltd., Inter City Baking Co. Ltd., Canadian Oil Companies Limited, Canadian Celanese Limited, Bruck Silk Mills Limited, Building Products Ltd., Dominion Tar & Chemical Company Ltd., Canadian Malting Co. Ltd., Canada Cycle and Motor Company Ltd., Dominion Engineering Works Ltd.

Table 5

Detailed Analysis of Changes in Working Capital
Canadian industrial corporations who utilized issues of securities and decreases in working capital in the financing of their fixed asset expansion policies.

1940

(000 omitted)
(22 companies)

Cash	$ 4,128
Accounts and bills receivable	14,343
Inventories	29,431
Investments	— 8,187
Deferred charges	1,536
Bank loans	— 2,178
Accounts payable	— 9,660
Reserve for taxes	— 23,885
Miscellaneous accruals	2,105
	$ 7,633

An examination of Table 4 shows funds provided from retained earnings ($15 million) and from new issues ($30 million) which funds were used to finance the excess expenditure made on fixed assets and investments in subsidiaries over the annual provision for depreciation ($39 million) and to finance the increase in working capital ($8 million). Table 5 sets out the pattern of the working capital increase for the year.

The increase in working capital as disclosed by Table 4 in light of the decreases in working capital utilized for financing fixed asset expenditures (Table 1—"A" companies) is accounted for by substantial working capital increases arising from the issue of securities by Aluminum Limited.

The management policy outlined in Table 4 is essentially one of expansion. No decision may be given as to whether or not such expansion is the result of an increased war effort. To form any such opinion, the activity of the individual companies concerned must be reviewed and each weighted according to the extent to which they are directly or indirectly occupied in war work.

Tables 6 and 7 present a summary "Application of Funds" and detailed "Analysis of Working Capital" for the one hundred and eighteen companies examined.

Table 6

Application of Funds

1940

(000 omitted)

(118 companies)

Source of Funds	
Net profit after provision for depreciation	$137,118
Depreciation charged to operations	73,458
Issue of—funded indebtedness	28,443
—common share capital	6,255
Sale of fixed assets	1,344
	$246,618
Application of Funds	
Cash dividends paid—common	$ 77,409
—preferred	10,978
Expenditures on fixed assets	88,239
Investment in and advances to subsidiaries	4,653
Redemption of—funded indebtedness	11,984
—preferred share capital	1,351
Increase in working capital	51,131
Miscellaneous	873
	$246,618

See reference to companies covered in Tables 1 and 3

Table 7

Detailed Analysis of Changes in Working Capital

1940

(000 omitted)

(118 companies)

Cash	$18,382
Accounts and bills receivable	47,401
Inventories	91,596
Investments	— 432

Deferred charges	1,052
Bank loans	—27,068
Accounts payable	—30,039
Reserve for taxes	—52,158
Miscellaneous accruals	2,397
	$51,131

An examination of Table 6 indicates an expansion by industry taken as a whole (weighted by the representative nature of the sample) showing an excess of expenditures on fixed assets over the depreciation provided of approximately fifteen million dollars coupled with a somewhat correlated increase in working capital of fifty-one million dollars. The funds for the expansion policies followed were provided from retained earnings ($49 million) and from a net issue of securities ($11 million).

Although the sample of Canadian corporations which was chosen is by no means all inclusive, it does give a fairly representative cross section of the Canadian industrial economy and serves to indicate qualitatively if not quantitatively the general nature of fiscal policies of industrial managements in the Canadian war economy.

REPORT WRITING AND THE ACCOUNTING PROFESSION

By Philip T. R. Pugsley, Chartered Accountant, Montreal

THE preparation and writing of reports is today one of the main activities of most accountants. This statement applies not only to practising public accountants but also to those in commercial enterprises.

The increasing complexity of business is forcing executives to depend more and more upon reports prepared by others to guide them in the decisions they make. No longer have men of action time to investigate in detail and see for themselves, as was at one time the practice. They are now forced to depend almost wholly upon information gathered by others.

No longer does it suffice for the accountant to be able to draw up a financial statement, or for the auditor to prepare a routine form of annual certificate to the shareholders. The demand for special business writings of all kinds crowds in upon them.

The decision to employ or to discharge hundreds of men may depend upon information available in written form. Governmental action, with its almost inevitable reaction on some industry, is guided largely by the interpretation of the flood of reported material which flows into official quarters.

There are practically no limits to the type of report that may be demanded of the modern accountant. It thus becomes important for him to acquire a good general knowledge of the technique of report writing.

Excellent sources of reference exist and offer much valuable information to those willing to investigate. Enterprising accountants are always on the alert for ideas which may help them to improve their report writing ability.

No one article can possibly deal with all the ramifications of this important topic. It is hoped however that this general introduction will arouse interest in a worth while study.

Background

Although the Domesday Book is perhaps the first major report to come down to us from a British source, hundreds of business reports from ancient Egypt are preserved to this very day. It will thus be seen that the formal pre-

sentation of facts as the result of investigation extends back to earliest times.

Value and Importance

Over three centuries ago a prominent writer penned these words, "Reading maketh a full man, conference a ready man, and writing an exact man." This statement is as true today as it was then.

Successful report writing requires not only reading, conference and other research, but also the ability to express oneself effectively by the written word. Careful preparation of different types of reports by the modern accountant gives him an excellent opportunity to develop his powers of expression.

The quality of the report he produces is the basis on which an accountant's ability is sometimes judged. This is particularly true of the public accountant, whose only contact with many people is through his reports.

Ability to write a satisfactory report is thus a great asset to any accountant.

Classification

The term report is generally understood to mean a formal statement in writing conveying information from one person to another, usually preceded by investigation on the part of the writer.

Reports vary in nature and importance. They may be short enough to be presented in the form of a letter or as a one-sheet memorandum. On the other hand they may constitute a number of volumes.

The form of many reports is stereotyped. Others leave scope for initiative and originality. The published annual reports to shareholders of limited companies, or a special investigation by an accountant on behalf of his client, are of the latter nature.

Relation between Reader and Writer—Perhaps the simplest general classification is the relationship between the writer and the person to whom he reports. On this basis most efforts fall into one of three groups.

The internal or administrative type includes reports which pass between persons of the same organization. An example would be the monthly interpretation of operating

figures compiled by the comptroller of a company for the benefit of the president or board of directors.

The professional report is one prepared by some independent specialist at the request of his client, and addressed either to the client or to the person for whose information the investigation is being made. In this category is found most of the work of the practising accountant.

An independent report is made without any specific request for it having been received. Many a market information report, for instance, has been drawn up in the hope that it might be sold to members of a trade. Individuals and organizations often prepare a report of this type when they wish to publicize or advance some cause that they favour, or expose some evil they wish to have remedied.

Subject—So numerous are the types of reports produced that efforts to segregate them by subject leave one with a wide variety of headings. Almost every subject of general importance has been reported upon, not once, but many times. A few examples would include financial, governmental, social, and scientific reports.

Scope—Reports might also be divided according to their scope.

Information reports include those where facts are gathered, summarized, and presented, with no effort being made to reach conclusions or make recommendations. Under this heading would come many types of governmental rereports which mean little until consolidated and converted into usable information by the Dominion Bureau of Statistics or some similar body.

Research reports include information gathered without the intention of immediate specific use. The findings of scientists sometimes accumulate for years in mere record form. Until pieced together by others they may fail to result in anything tangible.

Analytical reports are the most comprehensive type. Here an effort is made, not only to collect facts, but also to present them, to analyze them, to interpret them, to come to some conclusion, and finally to make recommendations. Because of its wide scope a detailed consideration of the analytical class of report should bring to light most of the techniques of report writing.

Analytical Report

The Report of the Royal Commission on Dominion-Provincial Relations is probably the most widely circulated analytical report in Canada today. As discussion of actual things is almost always more interesting than hypothetical ones, it is proposed to cite this valuable work as an illustration.

Preliminary Planning—A careful preliminary survey of the problem to be reported upon is most desirable. If the report writer understands thoroughly the purpose of the undertaking, planning will be more efficient and intelligent and much time may be saved.

It is a wise precaution to get a client to outline in reasonable detail exactly what is wanted. A few hours of preliminary discussion may save many hours later on, especially when the question of final fee arises.

Furthermore, the mere fact that the persons or the bodies requesting the report are required to put their needs in writing will compel those concerned to decide precisely what is wanted. This should facilitate matters considerably.

The importance of clear and adequate working papers has often been emphasized. It should suffice therefore to remind readers of the desirability of having adequate evidence in a readily accessible form. In other words, be prepared to substantiate the statements made in your report in the event of challenge.

A preliminary outline of what the writer considers the final report should contain will throw a spotlight on the nature of the information required. An analysis of the problem and a preliminary estimate of the research needed should be made and thoroughly discussed with the client. The scope of the investigation may thus be clearly established from the outset.

Collecting Facts—The use of questionnaires, interviews, libraries and other means of gathering information are dealt with in detail in many interesting texts. Book III of the Sirois Report, or the Report of the Royal Commission on Dominion-Provincial Relations, as it is officially known, is an excellent illustration of how many different sources are sometimes tapped. This book on documentation is also an excellent example of an adequate record of sources of information. In the case of the average investigation report

produced by an accountant much if not all of the documentation remains on his own files, and is merely available for reference.

Some important questions to keep in mind when collecting facts are:

1. Is the information which it is proposed to collect really necessary?

2. Has every effort been made to obtain any previous studies of the subject made by others?

3. To avoid overlapping, omissions, or other misunderstandings, have the efforts of all those engaged in collecting data been properly co-ordinated?

4. To avoid unnecessary delays, is the whole project being carefully planned and supervised to ensure a steady flow of information in the order of its importance?

5. Is an adequate record being kept of facts collected?

Briefly put, throughout the whole process of collection it is imperative to keep in mind the ultimate goal and to ensure that all effort is being applied intelligently to the achievement of this objective.

Organizing and Interpreting Material—Volumes have been written on the interesting subject of Business Statistics. Tables and charts take time to prepare but, if skilfully used, can often convey ideas and interpret data in a clearer fashion than any other known means. Over one hundred tables are presented in Book I of the Sirois Report alone, not to mention those in the other two Books.

Here again the whole objective is to gather facts which are pertinent to the subject under study, and which will give the writer an opportunity to reach sound conclusions. This is where the personal element assumes great importance. Most accountants are able to collect and organize information. A more limited number, however, are capable of sound interpretation. This is an ability which, though aided by experience and study, develops more rapidly in some than in others.

It is a difficult matter to avoid bias, and easy to see what one wants to see when interpreting data, without there being any intent to misconstrue the meaning of facts.

Conclusions and Recommendations—Conclusions are the summarization of the results of the investigation. Recom-

mendations are the suggested actions which should be taken as the result of conclusions reached. Both require the greatest of care, for they are the sections which busy readers usually study first. Upon them is generally based whatever action is taken.

They are not as a rule submitted unless definitely asked for, but are, of course, the most important part of the complete analytical report. Conclusions and recommendations take up the whole of Book II of the report on Dominion-Provincial Relations. They are undoubtedly the most important part of this effort; without them the whole undertaking would have been of vastly less value to Canada.

A report which reaches no conclusions and makes no recommendations is of mere academic value, until someone does the necessary interpretative work.

Due to its importance this is the section which usually gets the closest attention of both reader and writer. Clear and precise expression is here imperative.

Form of Analytical Report

Form is to a great extent a matter of personal choice. Although authentic material and sound interpretation are of great importance, the actual mechanics of presentation are worthy of careful study. Most reports prepared by accountants will not require all the elements mentioned in this article, but it is nevertheless of value to be reminded of their existence and use.

Under the heading of "Form of the Report" (Book I, page 17) the writers of the Sirois production discuss this very problem.

Cover—The cover of the average accountant's report is usually the source of great discussion when first adopted and then continues on in its same form for the rest of his active professional days. It may even pass on as a legacy to those who succeed him. This is not undesirable if the cover is a good one. However a report cover which is not striking in any way, or which is painfully striking in an unfavourable way, can do much harm. It is advisable to check from time to time with a good printer, and with some of the recipients of previous reports, to get their reaction to the cover in use. If the result is largely unfavourable or wholly negative, a change should be made.

Reference to Book I of the Sirois Report shows a neat and effective cover of black on red with a brownish-red binding. A sketchy outline of the map of Canada as a background for the name of the Royal Commission expresses pictorially the national character of the work. It is probably on lighter weight paper than that generally used by accountants. It conveys all pertinent information necessary to indicate the general nature of the contents, the name of the producer, and the fact that it is part of and not the whole of a report.

A cover that combines clearness with simplicity, and is striking without being gaudy, will impress those interested and put them in a receptive mood, even before they start to read. If it is a widely published report, an effective cover may mean the difference between its being read or ignored.

Title Page—The title page usually goes into slightly more detail than the cover. Quite often it is a repetition on white paper of what appears on the cover, as in the Sirois Report.

The choice of a title sometimes requires considerable thought. It must not be verbose but at the same time it should convey a brief word picture of the nature of the report. The title usually appears at the top of the title page and is sometimes followed by a brief sub-title further explaining the contents of the report. The names of those responsible for the effort then appear. Finally the name of the publisher is sometimes printed, immediately followed by the city and the year of publication. Many variations are used.

Copyright Notice—Occasionally a report is copyrighted, and in that event this fact is usually stated on the page immediately following the title page. Other uses are sometimes made of this space. If the report is being dedicated to some organization or person, for example, it might be mentioned here.

Authorization, Acceptance and Approval—The written authorization to proceed with the report and the acceptance of the assignment are sometimes included as part of the final report itself. This is desirable where the writer wishes to emphasize the limits of his investigation, or where spe-

cial circumstances should be called to the attention of the reader.

Where the name of the writer is not well known, or where he is a subordinate in a department the head of which has to assume final responsibility, a letter of approval or sanction for the report is sometimes obtained from his superior and published as part of the report. Occasionally it takes the form of a commentary and emphasizes to the person or body addressed the importance of paying attention to the effort.

Transmittal—A letter of transmittal may be a brief letter enclosing the report, or it may extend to many pages and be bound into the report itself. In the latter case it may refer not only to the terms of reference but also give a history of the project, explain the methods of approach to the subject, and even offer a précis of the report and its recommendations and conclusions.

In the report on Dominion-Provincial Relations the letter of transmittal comes immediately after the title page and consists of only two paragraphs. The first paragraph mentions the Order in Council pursuant to which the Royal Commission was formed, the second states that in spite of the outbreak of war intervening the Commission "believes its recommendations to be appropriate to meet the new strains and emergencies of war conditions." Thus the most important question that is likely to come to the mind of the average reader is immediately answered. In the Sirois publication the "Terms of Reference" and the "History of the Commission" are each dealt with separately, immediately before the main body of the report.

Table of Contents—The skilful use of sub-headings in a short report will generally preclude the necessity for a table of contents. In longer reports it becomes desirable for the contents to be summarized in table form. Headings and sub-headings should be arranged in correct relationship and set forth in a manner which will enable the potential reader to a get a bird's-eye view of what is in store for him. If we refer to the main chapter headings of Book I of the Sirois Report we find an excellent example of a table of contents.

Table of Charts—Where charts and tables of figures are numerous, a separate list is provided which generally

appears immediately after the general table of contents. This group may be headed "Table of Charts," "Illustrations," or merely "Tables."

Foreword, Preface, and Acknowledgment—The foreword, preface and acknowledgment are often embodied in the opening paragraphs of the average short report. In longer efforts they may appear separately and often take the place of a letter of transmittal, especially in the case of a general report not addressed to any specific person.

The terms foreword and preface are often used as if they were synonymous. Actually there is sometimes a difference. This would occur when one person or group is sponsoring the report, while another is doing the investigation. The former might then use the foreword to explain why they thought an investigation should have been made. The investigator could then use a preface to serve as a general introduction and to take the place of the letter of transmittal.

Acknowledgments may be made separately, or embodied in one or other of the introductory parts mentioned above.

Synopsis—A synopsis or condensed summary of the highlights of a report is of great value to the busy reader. It requires careful preparation to assure that it conveys correct information as to the pith of the effort.

A good synopsis is desirable for a number of reasons. It enables executives, librarians and others who may have neither the time nor desire to read the report in full to gain at least an idea of its contents. It gives the potential reader an opportunity to decide whether the effort warrants his attention, and also helps him to grasp the material more intelligently than if he read it without any preview. The mere fact of having to condense his effort may also help the writer to discover weaknesses in his case.

The synopsis usually precedes the body of the report and may be shown under such headings as "Abstract," "Summary," "Epitome," or "Introductory Summary." Many reports do not have a separate summary but attempt to achieve the same result, in part at least, by use of the introductory sections mentioned above, or by summarizing the whole effort in the opening paragraphs under the subheading of "Introduction."

Main Body of the Report—The main body of the report may be broadly divided into the introduction, the body or text, and the conclusions and recommendations. The handling of these three parts varies greatly depending on the nature of the subject and the methods of the writer.

The introduction, as mentioned above, may take the place of the other introductory parts already described. The quality of these opening remarks will often decide whether the rest of the report will receive careful reading.

The text or body of the report are terms which are sometimes used in a broad sense to cover all three parts here mentioned. In a more limited sense they refer to the detailed discussion of the problem after the introductory remarks, and before the recommendations and conclusions are presented. Clearness of arrangement and language are desirable to hold the interest of the reader.

The conclusions and recommendations constitute the most important part of the majority of reports, and usually receive the most attention. As a rule they appear last, but occasionally it may be thought desirable to present them first and then explain how they came to be reached.

Appendix—The appendix consists of supplementary information which though worthy of presentation with the report cannot be included conveniently as part of the main body. Book III of the Sirois Report entitled "Documentation" is an example of an appendix to a report.

Bibliography—A bibliography is often submitted either as part of the appendix, or as a separate section immediately following the appendix and preceding the index.

Index—An index is not generally used unless the report is a very long one. Its purpose is to enable the reader to refer promptly to some special part of the report which may interest him. While the table of contents is presented in the same order as the material, the index usually goes into further detail and is presented in alphabetical sequence. The various methods of indexing material are worthy of study.

Language of Business

Effectiveness, simplicity and clearness of language and presentation is the modern tendency in business writings. Stilted words and worn phrases are waging a losing battle.

Unless the reader is addressed in a manner which he understands, the report is unlikely to register effectively or have worth while results.

Knowledge gained by the investigator but poorly communicated or totally unconveyed is of little or no value to the reader.

Conclusion

An effort has been made in this article to remind accountants of the importance of effective writing to the profession.

If our activities are to keep abreast of commercial progress the tendency must be away from too much detailed checking, and towards more interpretative work. Report writing is excellent training in this latter field.

INTERNAL AUDIT FUNDAMENTALS

By Arnold O. Wolf

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Editor's Note—The internal audit is one of the significant developments in the accounting field and a subject of interest to chartered accountants and to students. With the kind permission of the National Association of Cost Accountants we publish the article on the subject prepared by Arnold O. Wolf for the Association's *Bulletin*. Mr. Wolf is a graduate of Columbia University, had experience in public practice with Messrs. Ernst & Ernst, public accountants, and is now head of the auditing department of the Scovill Manufacturing Company of Waterbury, Connecticut. The article is an exhaustive one and will be concluded in the February issue.

DEFINITION of Internal Auditing—Most writers on technical subjects start off with a definition of their subject. I was going to be unconventional in this respect, but in reading up on the subject, I was surprised at the confused terminology in use. Internal check, internal control, and internal audit are used rather indiscriminately, so I think it is better if we clean up this matter first.

Internal check should mean that system of accounting procedures employed in a company by which the work of one employee automatically and independently checks the accuracy of the work done by another.

Internal control should refer to the whole phase of control exercised by management over the operations of the

business. It would therefore include internal check and internal auditing as separate methods of control.

Internal auditing is a method of internal control used by management to complement the system of internal check and to assist it in its control of the financial operations of the business.

While internal auditing is regarded by many as an important supplement to internal check and because an internal auditor should check the efficiency of internal check systems, my discussion will include both internal check and internal auditing.

An internal auditor is usually a man of the same qualifications as a public accountant except that he devotes his entire time to one company. Of course there are many kinds of internal auditors, ranging from a junior clerk who merely checks invoices all day long to a member of a large staff of a big company where the auditor is continually travelling from one end of the country to another. Never having been at either extreme, I will limit this discussion to auditors of companies the size of my own, and I think the situation might very well fit most others.

In some cases (33 out of 285 cases in the National Association of Cost Accountants 1939 survey) auditors are the chief accounting officers of a company, but I will discuss only an internal auditor who is separate from the chief accounting officer or controller.

Evolution of Auditing—Years ago the concept of auditing objectives was what is now known as detailed auditing. The objectives were mainly to uncover fraud and errors, and they were accomplished by verification of all supporting documents, of the accuracy of all postings, footings and summaries, and by investigation for items not entered.

As corporations grew in size, this became a tremendous task and was found to be too expensive for the benefits involved. The time and cost of such audits had to be reduced. In order to accomplish this, auditors held the same viewpoint of verification, except that they cut down on the items checked in each step, and this came to be known as testing and sampling. The untested months were assumed to be correct.

More recently the so-called balance sheet audit approach was formulated. Balances at the end of the year were

verified by various short-cut methods and recourse to outside sources of information. This was found capable of proving that the entries during the year were substantially correct without the necessity of auditing each individual transaction. Unfortunately, detailed audits were discontinued even in cases where the system of internal check was weak. However, this method is capable of uncovering the major portion of errors usually found in detailed auditing. It does, nevertheless, make internal check an important item in today's accounting, and the same is true about internal auditing.

Auditing has become more important during the last twenty years, especially in the case of large corporations where stock ownership is to a great extent divorced from management. Stockholders depend on auditors' reports to inform them of the true financial position of the company and of the efficiency of the management.

Auditing methods considered up-to-date today may not be adequate tomorrow. The ever-increasing use of machines in accounting gives us better control of the mathematical and clerical accuracy of the records, and auditors now may devote more time to problems of a wider scope. In this connection, I wonder if there is not too much tendency on the part of internal auditors to spend a lot of time on the general accounting and to overlook auditing costs, estimates and budgets. Maybe I am treading on dangerous ground in making such a statement to a group of cost accountants, but it seems that with the reliance now being placed on cost records and budget reports, an auditor might well spend some time on such problems. Usually, cost records are controlled on the general ledger by one account and what goes on in the details of that account out in the cost department is often just a complicated mystery to the auditor.

Auditing is one profession that cannot stand still, but must move forward in all respects—in its programs, education, research and development.

Present-Day Importance of Internal Auditing—Public accountants are themselves reviewing their own methods and practices, and the Securities and Exchange Commission has made an intensive study of the same problem to determine whether they are adequate to meet present-day needs, and it might be well for internal auditors to do the same.

The New York Stock Exchange report by a sub-committee on audits recommends among other items the following: "Independent and efficient accounting and internal auditing departments are a vital factor in assuring the accuracy of the books and published reports. The importance of the Controller or Internal Auditor in these connections is paramount and the Board of Directors should take an active interest in his selection."

Regulation S-X, Uniform Accounting Requirements for Financial Statements, issued by the Securities and Exchange Commission includes among the rules regarding certification by public accountants the following: "The accountant may give due weight to an internal system of audit regularly maintained by means of auditors employed on the registrant's own staff."

In a survey by the National Association of Cost Accountants in 1939, 101 out of 285 companies reported that in their companies there was a department or individual charged with the duty of internal auditing. Out of the remaining 184 cases, only 20 reported that no one was charged with this duty, 11 left it to the public accountant, and the remaining companies named other persons within their organization as charged with this duty in addition to their other functions.

The development of large-scale modern corporations necessitates firmer control by management, which cannot any longer control all functions from personal observations and contact. Management must rely on reports, statistics and analyses which must be fairly accurate; otherwise they are meaningless. In assuring the reliability of accounting data, internal auditors have become a special tool of management in control functions.

In recent years the margin of profits has become smaller and smaller and calls for more efficient management. Extensive requirements by governmental agencies in the way of reports calling for more accurate accounting are increasing problems of management in which internal auditors can be of real assistance.

Objectives of Internal Auditing—What good is an auditor? In most cases he is regarded as just a snooper and critic who goes around complaining about something that happened a long time ago. He is just an additional expense and accomplishes nothing productive.

On the other hand, his prime purpose is to protect the interests of the stockholder and assure the management that the system of internal control and the general accounting plan is being followed accurately, honestly and as originally outlined.

During the course of his examinations, he may be able to suggest more efficient methods of accomplishing the same result; point out sources of unnecessary expense; in such and other ways be helpful in saving money for the company. In one of our divisions, the accounting department makes a habit of saving up a lot of questions for the next visit of our staff and asks our opinion on these matters. In this particular instance, we have found it necessary to be cautious in advancing suggestions as they are prone to act on them so quickly that we may find ourselves in hot water if the suggestion has been made too hastily. This, of course, is an ideal situation and is true only in this one location, to our sorrow.

Many times an auditor exerts a purely psychological influence on the character of the work of employees, who, knowing that they will surely be audited, will take better care in carrying out the work assigned to them.

Many times fraud can be prevented by an alert auditor before it occurs. The problem of the outside auditor, as stated by the American Institute of Accountants, is "always to provide adequate protection at a cost which will not be an undue burden on the great majority of corporations which are honestly administered."

The auditor is often a source of information of a statistical and historical nature, as most auditors (I hope) keep beautiful files of years and years of working papers.

Most auditors assist the public accountants in their year-end examinations by preparation of details which it would be more costly to employ public accountants to obtain, and are able to make suggestions to speed up the examination. The SEC recognizes the importance of internal auditors by stating that public accountants may place reliance on the work of internal auditors. In our company, our audit staff makes copies of most of our audit working papers for use by the public accountants, and while the carbon idea is a nuisance to us, there is no question but that it saves time on the year-end work. Copies of all our audit reports are given to them as well.

This more or less answers the foolish question of "who audits the auditors?" They audit us and we audit them.

The National Association of Cost Accountants' survey revealed that companies included in its survey indicated the chief objectives of internal auditing in the following order of importance to them:

1. Location of errors and promotion of uniformity and accuracy in recording transactions,
2. Verification of accuracy of financial statements and reports,
3. Control and reduction of costs,
4. Prevention and detection of fraud,
5. Analysis and improvement of system of internal check,
6. Audit of subsidiaries and branches, and
7. Special investigations.

You will note from this that the National Association of Cost Accountants has very kindly put the word "prevention" in front of detection of fraud. This is one of the most under-emphasized results of internal auditing for it is a pretty hard case to prove and only by "eternal vigilance," as one man in our organization has termed it, can this be accomplished.

Other objectives named were many and varied in their scope, such as:

Tax-savings, satisfying requirements of public accountants, surveying personnel and office methods, co-ordination of operating departments, improvement of regular routine, verification of insurance coverage, determination of condition of receivables, education of plant and branch employees in their work, control of commitments and manpower, encouraging efficiency, etc.

In a broad sense, as Professor Brink has put it, there are two levels of internal auditing—the passive level and the dynamic level.

The passive level relates to functions of a routine policing nature—guarding against errors and fraud. While these functions are still as important as ever, they should be regarded as a means and not as an end. The more interesting part of internal auditing is that which is performed at the so-called dynamic level, such as appraisal of the procedures followed, activities dealing with compliance, analysis of data obtained in the course of verification, training of personnel and miscellaneous services performed for management.

An Expense or an Economy?—Is internal auditing an

expense or an economy? This is one of the most difficult questions to answer. While I am convinced that the answer is that it is an economy, I know that it is a pretty hard thing to prove, because there is no adequate measuring stick to evaluate the services rendered by an internal auditing department. If the evaluation is made on a profit and loss basis, it cannot be done except on a long-term basis, as some benefits derived from such a service might extend for an indefinite period. As internal auditing is primarily a protection service, its effect on the efficiency of the operation of accounting records, even though to some extent only psychological, is difficult to measure in terms of dollars and cents. There are two kinds of yardsticks which can be applied to measure the value of such a service.

First, there are positive yardsticks which can be applied, such as,

Recoveries of overpayments,
Savings in cash discounts,
Reduction of time required to do certain jobs,
Reduction in cost of outside audit,
Elimination of consumption or waste of supplies,
More efficient use of company equipment, and
Use of department for special services which otherwise might have to be done by outside agencies at greater cost.

These yardsticks can be used to a large extent to measure value in money if estimates can be obtained of the amount of money saved. However, as some of these items may very well extend over indefinite periods, their value cannot be determined accurately.

Secondly, there are the negative yardsticks that may be applied for evaluation—methods used by measurement of inefficiencies or losses sustained, such as,

Defalcations, and if there is no provision for the prevention of this bugaboo, I don't see how it can be measured, as it may never be found out,

Government penalties sustained by reason of erroneous reports being made on the basis of inefficient accounting records and reports,

Unsatisfactory conditions surrounding the operation of accounting records and supporting data, which might very well affect sales and manufacturing policies to such an extent that losses occur.

In addition to these methods that might be used to evaluate auditing services, costs might be compared with those of other companies' auditing costs or with the costs

of prior periods in the same company, or with what might be charged by public accountants for the same service.

I believe, however, that a broader view should be taken and the measurement should be made by management in terms of assistance rendered to them in the conduct of the affairs of the company. Judgment must be used, and consideration given to whatever limitations have been placed on the department as to the scope of the work, facilities furnished, amount allotted, personnel of the department, and the co-operation given to the department by other department heads. Naturally, if these conditions are unfavourable, audit service can very well be merely an expense. Under favourable conditions, it is very definitely an economy and the measure of it can be limitless.

To Whom Should Auditors Be Responsible?—This question, of course, depends to a great extent on the manner in which authority is delegated by the board of directors. Many firms have on their boards a committee on auditing, and the public accountant and the internal auditor report directly to this committee. This sounds good in theory, but doubtless many of you have had sad experiences trying to deal with committees of more than one person.

Some people hold that the auditor should be responsible to the president, and this may be all right if you have a president who is accounting minded. Others say he should report to the treasurer on the theory that he is the chief financial officer of the company. However, you occasionally find situations where the treasurer is a wizard at financial manipulations but not so qualified on accounting details.

I would say that in most cases the auditor is responsible to the controller, and I agree that this is the way it should be. Auditors should report to the controller, as he is one man who can speak the same language and has the direct line authority to do something about your findings. Sometimes, you find that he does not, but that is his problem and all you can do is to keep on stating your case until he either does something about it or gives you a good reason for you to give up.

I think we have about as sensible an arrangement in our company as is possible. Our department is responsible to the controller and our reports addressed to the treasurer, with copies to the president and controller. If there is

anything in the report important enough, one of the three is bound to do something about it.

In the National Association of Cost Accountants' survey, out of 101 auditors, 38 report to the controller, 19 to the president, 24 to the treasurer, and 1 to the board of directors.

Accounting Plans

Basic Plans—Just as an architect draws plans for a house, so must a business concern draw accounting plans for recording the transactions it expects to consummate in its business. The basic plan is the chart of accounts which usually is in such form that a trial balance taken of the accounts is readily transformed into a balance sheet, profit and loss statement and other related statements. In many cases, this is supported by an accounting manual.

Before any chart of accounts or accounting manual can be intelligently drawn up, it must first be ascertained what information is desired. Of course, the first need is that information necessary for management to run the business successfully. Other needs to be considered are the requirements for proper reporting of taxes and statements to governmental authorities. In the last ten years new requirements have sprung up and we must now consider what information is required by the various social security laws, the complex state sales and use taxes, and the Securities and Exchange Commission. In addition, new trends in presentation of information to stockholders must be followed, as the ownership in many companies has become more widespread. Companies with foreign units have found a lot of headaches in the last two years in foreign exchange problems and found it necessary to revise their accounts and procedure.

Accounting terminology, unfortunately, is not highly standardized—even cost accountants cannot get together on whether to call overhead "burden" or burden "overhead." We have reserves for bad debts and reserves for doubtful accounts; fixed assets and permanent assets; unexpired insurance and prepaid insurance, etc. Some societies are making strenuous efforts to standardize terminology, but it seems a long haul. Whether it is stubborness or just the good old American way of doing things, I do not know, but it certainly is confusing to the layman.

In this connection, there are some account titles which are my pet hates, such as "items in suspense" which could really be applied to every item on the balance sheet, as we theoretically suspend every account at a certain fixed time. The next minute many accounts change. Another is "accrued expenses." To my mind, there is no such thing; either it is an account payable and we are too lazy to classify it, or it is a reserve of some kind.

An accounting manual is one way of eliminating the bug encountered in any sizable organization (i.e., "passing the buck"), as responsibilities are definitely determined in advance and are in writing.

Manuals for cost-keeping, budgets, payroll records, etc., should be set up along the same lines in which the general accounting manual is prepared and should interlock.

The Association's survey showed that 117 companies had accounting manuals, 118 did not; whereas 80 had cost manuals, 46 had budget manuals, 41 office manuals, and only 19 audit manuals. Maybe they have good auditors who do not need manuals, but I think they would be still better with them. With a set of ideal charts and manuals in force, an auditor's task would be simplified considerably, as much of his time is spent in trying to find out what the accounting policy of his company is.

Statement of Accounting Policies—Included in any good accounting manual should be a definite statement of accounting policies regarding treatment of various transactions and accounts. For example, there should be a statement of policy as to the method of building up certain reserves—for bad debts, depreciation, vacations, taxes, etc. It should contain instructions regarding treatment of bad debts written off and recovered, profits and losses on disposal of fixed assets, etc. Certainly important matters, such as decisions as to what items should be capitalized as fixed assets, treatment of patents and amortization, decisions on whether tools should be inventoried, and treatment of consignment accounts, are all better stated in writing in detail. It may be argued that it is sufficient to state that the company is on a cash basis or on an accrual basis, but you would be surprised how many different ideas you get on these subjects when you go around even to various divisions of one company.

It is important that all this should be in writing, as

various matters are subject to revision on account of changes in requirements for tax returns, needs of managements, reports, etc. If the instructions are written, we not only have uniform treatment and quick reference by outside agencies, but a valuable historical file as to the changes in treatment over a period of years.

Reports to Be Prepared—A schedule of reports to be prepared should be included, indicating the responsibility for the reports, how often they should be prepared, to whom sent, and an outline of the form in which they are to be submitted. Unless reports by various units are submitted in some degree of similarity they lose their value for comparison and consolidation purposes. I'll grant that the only figures some executives are interested in are the net profit and the cash on hand, and that we can go too far in standardization to the extent that we stifle initiative and imagination, but I do think an intelligent mean can be arrived at in the presentation of reports.

Maintenance of Records, Files, Etc.—This is one subject that is passed up too lightly by many people. In this connection, you find a lot of "hoarders" who will save every scrap of paper that ever came into their possession and clutter up their files so that it is a job to find something you are really looking for. Any lawyer will be able to tell you how long to keep your various records.

Instructions for Year-End Procedure—A more or less detailed outline of procedure at the year-end should be included and prepared in conjunction with the outside auditors, especially in the case of a company with far-flung branches or divisions. These should be reviewed immediately upon the completion of each year's final statements while all the "headaches" encountered are still fresh in everybody's mind. Specific reference should be made to the responsibility for preparation of certain data, and the work of internal auditors should be considered to eliminate duplication of work. Quite a saving in the time required by outside auditors (and incidentally a saving in the fee) can be accomplished by a co-ordinated set of instructions issued by the central accounting executives.

Provision for Revision—Charts, manuals, forms, reports, etc., should be constantly reviewed and changed to meet ever-changing requirements. This may sound like a lot of

work, but if considered in the light of eliminating confusion at closing dates, it will be an economy.

Specified steps should be provided for revisions and, while all revisions should be issued by a central source, no prohibition should be placed on employees for making suggestions for improvement. These should be made in writing to the responsible head and answered by him in writing either affirmatively or negatively with reasons. Employees will have more interest in accounting plans if they feel they have a part in them, and more efficient operation will result. When I was in public accounting, I heard many a good suggestion made by a subordinate who did not dare make it to his chief, because the latter would resent the implication that he was not capable of knowing it all.

Internal Check

Definition of Internal Check—There are many definitions of internal check—some short and some long and quite involved. The shortest one I have found is that by Heckert in his book, *Accounting Systems Design and Installation,* in which he says it is "merely the checking the work of one employee by that of another." Another writer says it is the "control of each step from the point where the company's cash is paid out on proper authority, to the point where the company receives cash for merchandise delivered without suffering any losses." Other writers include detailed precautions to be taken, but the substance of all definitions is that it is an automatic check and reliance is placed on the inherent honesty of most people—not merely honesty in the sense opposed to fraudulent peculations but honesty in carrying out their duties as planned and in reporting errors found. Without this there can be no internal check and I think the reliance on it is justified, as most people are honest. In a study made of 1001 embezzlers, it was found that only 2 out of 10 embezzlers were office men, and most of the rest were branch managers and salesmen.

Importance of Internal Check—All accountants rely on the efficiency of the system of internal check in determining the extent and scope of their audits. The American Institute of Accountants, commenting on the nature and extent of audits, states that auditors will necessarily take into consideration the system of internal check and control.

In the McKesson & Robbins case, the SEC states that

"they are convinced by the records that the review of the system of internal check and control . . . was carried out in an unsatisfactory manner," and that "this vital and basic problem of all audits . . . has been treated in entirely too casual a manner by many accountants." They further state that "since in examinations of financial statements of corporations whose securities are publicly owned, the procedures of testing and sampling are employed in most cases, it appears to us that the necessity for a comprehensive knowledge of the client's system of internal check cannot be over-emphasized."

They go further to detail twelve circumstances regarding the lack of internal control which they claim should have helped reveal the gross inflation in the accounts. Of course, they list altogether forty-five circumstances regarding the whole picture in their criticism, but it is interesting to note that those regarding internal check are listed first.

While no system of rules and regulations will change human nature, I believe an adequate system of internal check and control will have the tendency to keep employees "on their toes." Naturally this is more important in the case of large companies with many employees and a greater delegation of authority with less direct supervision by those charged with the management of the company's affairs. The cost of actually auditing every transaction would be prohibitive, and the extent to which auditing can be curtailed depends largely on the efficiency of the system of internal check of a company. It goes without saying that the better the system the less the cost of auditing. At the same time the system should not be so elaborate as to cost more to run than it would be worth.

Machine Accounting—There is an ever-increasing feeling that machines can play a large part in providing safeguards and controls in accounting methods. Automatic totals, counters and multiple posting, featured in modern machines, provide protection against fraud as well as clerical accuracy and economy in the cost of routine work. For example, when cash receipts are being posted to accounts receivable cards, if the posting is made simultaneously to the cash receipts book and automatic totals are obtained, it is difficult to commit fraud by use of different amounts in posting.

I feel that one of the reasons we do not have more machine accounting than we do is because we do not get the maximum out of our machines. There is a tendency to employ cheap operators—cheap in the sense that while they may be mechanically efficient, they have not been instructed in the manner in which their particular operation fits into the general picture, and become mere robots. This tendency is caused probably by the fact that the machine usually costs quite a bit of money, and we feel that we should compensate for the expense by employing low-paid operators.

Of course, I imagine there is a certain point at which we could have too many machines. Care should be taken in selecting machines for one-purpose jobs, because it is pretty hard to fire a machine, and the tendency is to create some job for it.

Delegation of Authority—Any review made of the system of internal check should include a general review of the methods by which authority is delegated. Busy executives are inclined to do this carelessly, resulting in an inefficiency which the general plan was designed to avert. Too often we find authority delegated in a careful manner in the general plan to certain key men, but the job has been turned over to some girl who does a mechanical job of it and who sometimes has not been properly instructed in even the mechanics.

If I had my way, I would throw away all rubber stamp "OK's" and signatures which are in plentiful use, and force the person who is to approve something to actually sign it. I'm sure these people would be shocked if you suggested they have their personal checks pre-signed by a machine, but think nothing of rubber-stamping their approval of an expenditure of a sum of many times their bank balances.

Vacations of Employees and Rotation of Employees—Many times fraud is brought to light by enforced vacations. In the McKesson & Robbins' case, George Dietrich, with one exception, was away from the plant only a half day. Robert Dietrich was away for two or three days at a time, never more. When George Dietrich was away for even a few hours, Robert would occupy his office (next to Coster) but while there would never do any of his work .

Vacations and rotations of employees serve other uses

than discovery of fraud. Some people get into a rut very easily, and if someone else takes over their job even for a short time, errors not only of a clerical nature but sometimes errors in principle will be disclosed by a fresh approach. Besides, it is not much fun to take a vacation and then come back to a desk piled high with work.

Internal Auditor Part of System—There is no system of internal check if the work of one employee does not automatically check that of another, and of course in a large company this is supplemented by an internal auditor who checks the work of most or all other employees.

In addition to checking the work of other employees, it is the internal auditor's duty to see that the actual system of internal check is operating efficiently. We can refer to any number of textbooks on accounting and copy off an ideal system of internal check, but it is an entirely different matter to keep it functioning as originally intended. It is like building a beautiful streamlined automobile and putting in a 1930 model motor. This function by the auditor entails comparing performance with standards, as you cost accountants might say.

Illustrated Methods of Internal Check—Much has been said and written on methods of evaluating internal check—whether to approach the problem by the use of a questionnaire, check-list, organization chart, accounting record or by flow-chart. Stephen Gilman, in the *Journal of Accountancy* for December 1940 presents an interesting review of each and concludes that a practical solution would be to start with a fairly short general questionnaire to be filled in at the start, obtain lists of procedures, records, record keepers prepared by the client, and use classified check lists as a basis of a running record during the progress of the engagement.

In order to give an illustration of proper methods of internal check, I have prepared a list of questions concerning procedures under various headings in such a way that if the answer is "yes" it indicates that there is adequate internal check. This questionnaire appears as Appendix A at the end of this article. Naturally these questions have been designed along more or less ideal lines and it would be difficult to find any company answering "yes" to all the questions, due to the limited number of employees in most

cases. In a small company, the internal check may be accomplished by an intelligent rotation of employees' duties. Both prevention of fraud and the minimizing of errors have been considered in making them up.

(to be concluded in February)

ECONOMIC NOTES

Limitations of Price Control Plans

Editor's Note: This is another in a series of notes on economic subjects by Lawrence B. Jack, M.A., Montreal.

PRICE controls only become necessary when a country faces the prospect of reaching full employment which will tend to create a scarcity of consumers' goods in relation to increased purchasing power. This will always be the case in a war economy because so much production is diverted to armaments and military equipment, yet full employment, often at considerably increased wages and salaries, can be achieved fairly rapidly. Even in the initial stages of a war economy, when there are large masses of unemployed resources both of labour and plant capacity, it is wise to set up control mechanisms because some prices are bound to rise. This may develop from one or several of the following factors: bottlenecks in production, increased excise and sales taxes, rising ocean freight rates and marine insurance, and the technical factors of time lags in industry which lead to a vast outpouring of funds during periods of plant construction and before production can get under way. For this reason selective price controls of the type that Canada had in effect for the first two years of war are extremely useful; sooner or later, however, they must be superseded by more stringent measures.

The table below shows price changes in four countries after two years of war. While direct comparisons between economic phenomena in different countries cannot validly be made, a short discussion of different factors operating in each country and of the price controls in force will throw some light on the wide discrepancies shown and suggest future developments in coping with the inflation problem.

August 1939 - September 1940	*Wholesale* %	*Cost of Living* %	*Food* %
Canada	28	13.8	24
Australia	15	8.6	3
United States of America	22	9.6	17
United Kingdom	53	28.4	22

British imports (like Australian) are all water-borne and therefore have felt the full force of greatly increased ocean shipping and marine insurance rates, with the result that wholesale prices and cost of living are by far the highest there. This factor has been reinforced by relatively heavy sales taxes and increased excise taxes. On the other hand, food prices have been kept relatively well in hand, because the Ministry of Food is paying subsidies of at least £100 millions a year in order to prevent undue price increases. Nominally, however, British price controls are still on a selective basis and are administered by several agencies which often work at cross-purposes. They have been reinforced by a high degree of rationing and, as might have been expected, since this technique was put into force on a wide front a few months ago British prices have remained relatively stable.

Australia, on the other hand, has had over-all controls ever since the outbreak of war and it has experienced the least price rise in spite of the fact that all its imports are water-borne and excise taxes have been appreciably increased. Australian price control techniques attempt to reduce the margins of all dealers in commodities, although they do provide for price rises resulting from uncontrollable causes. In general, wholesalers' price margins have been widely reduced and the same is true to a lesser extent of retailers' margins, with the excellent results noted in the table. The very small rise in food prices has resulted from the fact that exportable goods (in the case of Australia this includes a very wide range of food products) are distributed internally at extremely low prices, a pool is made of the proceeds from exports, and part of this is distributed to those producers who sell only in the domestic market. In this way both consumers and exporters are dealt with reasonably fairly. An extra aid in holding down prices is the fact that Australian wages for more than ten years have

been tied to the cost of living, with the result that the public has long since been used to a wide measure of governmental control and there were only limited possibilities of raising wages in advance of price rises.

Canada established selective price controls early in the war, which operated admirably until supply conditions became excessively tight as a result of the American armament programme. It was then found necessary to put into effect the present price ceiling plan and full wage controls. There is reason to hope that this scheme will operate for a time at least as favourably as the Australian, unless it should happen that potential American price increases should prove a fatal magnet to the Canadian situation. Provision has been made, however, for import subsidies which will help to insulate Canadian prices from such a development and it is believed that plans may be set up to handle the export trade somewhat along Australian lines. It has been emphasized by the authorities, however, that rationing will definitely become necessary in certain lines as a supplement to price control. In the light of the British experience, this is obviously sound theory and should be quite as effective here.

Finally, the Americans are still determined to proceed with selective price controls. In that country it is politically dangerous to put a ceiling on either farm prices or wages, with the result that the price control authorities' hands are pretty well tied. But since the United States is relatively much less dependent upon imports than any of the other three countries, it is probable that whatever can be achieved internally by selective price controls will have the greatest effect there. There is no doubt, however, that rationing will be ultimately necessary if the war is prolonged and if American authorities are really intent upon preventing an inflationary price rise. Certainly this has been the experience in Great Britain and the expectation in Canada; probably the Australians will be forced to follow suit, because their technique of controlling profit margins has its limits. Thus the United States may by-pass the intermediate stage of a price ceiling plan which now appears to be necessary for Canada, but which, as the authorities fully recognize, must be supplemented by rationing if it is to be wholly effective. All these different approaches to price control,

therefore, lead to the same thing in the end: rationing is the only possible solution to the price problem if a country's war effort is to be great enough to ensure victory and at the same time the dislocations resulting from transfer of productive resources from consumers' to military goods are to be minimized.

Lawrence B. Jack.

Montreal,
16th December 1941.

GLIMPSES OF CURRENT ACCOUNTING LITERATURE

A Summary Prepared by John Douglas Campbell,
Chartered Accountant

BULLETINS

(1) Cost Accounting

BULLETIN No. 5, Volume XXIII, 1st November 1941, published by the National Association of Cost Accountants covers relatively specialized topics arising from the Second Revenue Act of 1940 (U.S.) and the Excess Profits Tax (U.S.).

Frederick E. Burnham discusses in an article the question of Amortization and Defense Certificates dealing specifically with the requirements of Section 124 of the Internal Revenue Code (U.S.).

Although the article presented by George F. Brewer on the Excess Profits Tax as a Factor in Cost and Selling Prices is based on United States legislation it carries a certain amount of interest for Canadians.

The general nature of the Excess Profits Tax (U.S.) is set out and the question as to whether such tax is a division of profits or a business expense is considered.

In referring to the probable effect of the Excess Profits Tax on management policy both the theories of conservatism and expansion are considered, and specific examples covering each theory are discussed.

Bulletin No. 6, Volume XXIII, 15th November 1941, is devoted to an outline of "Accounting for Air Transportation." M. W. McQueen in an interesting article on the above

topic outlines in general the uniform system of accounts which at present is utilized in this type of organization and discusses certain accounts and the method of handling some accounts which are more or less peculiar to the air transport industry.

The system of inventory recording using correlated purchase and perpetual inventory record cards and the nature of the inventory control exercised is interesting. "This system provides for verification of quantities on hand of faster moving items several times during the year and adjustment of inventory records at each verification . . . . This system has functioned with a minimum of effort and has resulted in not only keeping the stocks of obsolete items at a minimum . . . . but also has maintained necessary stocks of all items on hand."

The various types of expenditures and revenues peculiar to the air transport industry are covered and the routine procedure of accounting for tickets, ticket sales and unearned transportation at any given time is clearly outlined.

The article is informative not only to those in direct contact with air transport companies but to anyone interested in the application of accounting problems to varied situations.

(2) Accounting Research

In September 1941 Accounting Research Bulletin No. 12 (Special), entitled "Report of Committee on Terminology," was issued by the American Institute of Accountants.

The bulletin sets out by specific reference to the situations where an appraisal surplus is created and where a paid-in surplus arises as a result of an acquisition of legal capital at a discount, the conflict of value and cost concepts of the balance sheet and accounting in relation to the surplus account.

Based on the above discussion the conclusion is drawn that the abandonment of the use of the term "surplus" would be "a major step towards making the proprietorship section of the balance sheet more significant. It would lead to the substitution of really descriptive specific titles for uninformative classifications."

Recommendations for the drafting of a report by the Committee on Accounting Procedure on the above aspects are outlined.

ARTICLES

(1) Auditing Standards

Samuel J. Broad in a paper, "Auditing Standards" presented at the 1941 annual meeting of the American Institute of Accountants and reproduced in the November 1941 issue of *The Journal of Accountancy*, indicates the necessity for a bridge of "standards" linking the underlying or controlling principles of auditing and the actual procedures and programming of the audit.

The question of "reasonable evidence" and the significance of correlated materiality and relative risk are considered in discussing the underlying or controlling principle of auditing "due care." Specific case examples are used to indicate the application of the general principles mentioned to the customary audit program.

Previous to outlining a series of twenty-six auditing standards the statement is made that "There need be nothing revolutionary in a statement of auditing standards; it entails rather a setting down or codification of standards which competent practitioners already recognize in their individual practices." Special care is exercised throughout to remove the possible mistaken conception that the creation of the standard involves any degree of rigidity. "They leave full scope for the exercise of professional judgment as to 'how' and the 'how much' of auditing, and ample room for the development of new procedures."

The following general standard set out in regard to the item of inventories serves to indicate their general nature: "The auditor's opinion as to the inventories must be based on his examination of the accounts, the stock records (if any), and other data supporting the inventories, supplemented by his review of the methods and basis of taking and pricing the physical inventory itself. The extent of his tests of the records should be such as to satisfy him as to their *bona fides* and reasonable accuracy."

The significance of a group of auditing standards acting as an "objective yardstick" against which one could measure individual judgments is indicated with specific reference to the manner in which they may be utilized in the determination of what constitutes "due care."

(2) Accounting Records

F. A. Shick in an article "The Elimination of Cents from Accounting Records," published in the November issue of *The Journal of Accountancy*, indicates by a practical application the benefits and procedure of cents elimination from the accounting records.

In discussing the question of economy an attempt is made to indicate the significance of cents recording in the transactions of the average corporation. Definite reference is made to the savings arising from cents elimination in regard to labour, time of preparation, paper consumption and filing space. In the case example studied (Bethlehem Steel Corporation) the claim is made that these savings have been substantial. The additional benefits in the field of statement presentation are also mentioned.

The actual treatment of the elimination of cents in certain particular sections of the accounts is interesting: "We eliminate cents wherever, and as soon as, they appear, and all subsequent accounting operations, in all accounts except those in which cents are indispensable, are conducted in whole dollars." The cents are accumulated at their source and treated in such a manner that they will not interfere with later accounting processes.

(3) Purpose of Accounting-Interpretation

In an article "Interpreting the Results Thereof" published in the November 1941 issue of *The Journal of Accountancy*, William H. Whitney sets out clearly his opinion as to the responsibilities of the auditor to the layman on the question of interpretation.

The article deals primarily with the question of terminology and the extent to which accounting terms used at present meet the requirements of a "translation from language which readers do not understand into a language which readers do understand."

In discussing the balance sheet the suggestion is offered that the term "funds and unabsorbed expenditures" be used in place of the present term "assets" on the ground that it would be not only more informative but also a term "which emphasizes the accounting significance rather than the value or worth significance of the monetary amounts on the debit sides of balance sheets."

The interrelationship of the income statement, balance sheet, and surplus account is designated and the importance of the three in disclosing the flow of funds within an organization during any given period is stressed.

A special section is devoted to a discussion of the short form of audit report and the extent to which this report form falls short from an interpretative standpoint.

"Thus clear interpretation is something more than a mere philosophical, theoretical or academic issue. It is an instrument which accountants can use in the task of defending sound traditional accounting procedures when they are attacked."

Book Review

The Control and Valuation of Inventories—Selected Papers —(Published by the National Association of Cost Accountants, 385 Madison Avenue, New York City, 1941, cloth, 416 pages, price $3.)

The book constitutes a compilation of articles which have been published separately in previous bulletins and year books of the Association in addition to several specially written and previously unpublished papers. They present in all a well-balanced and concise treatise of the inventory problem in all of its aspects. It brings to business executives generally a full realization of the importance of real inventory management in their companies.

The book proper is divided into four distinct parts dealing with inventories from the standpoint of control, valuation, taking and practice. This is preceded by an introduction by Wyman P. Fiske outlining the scope of the ground covered and is followed by a bibliography of current literature on inventory control and valuation.

The method of presentation in the first three parts follows essentially the same pattern—an introduction of the aspects of the problem followed by practical cases drawn from a group of representative and diversified industries.

Part I deals with the question of inventory control, the aim of which is "to provide for the proper quantities of the right kinds of merchandise in the right places at the right time." Special care is exercised in this division to set out that the mere existence of the tools of control (perpetual inventory records, minimum quantities, etc.) does not

constitute control, but that actual control constitutes the use which is made of such tools in reaching the aim previously outlined. The question of inventory control is traced from the raw material purchase through the productive process (both constant and fluctuating production) to the finished goods inventory.

Part II covers the valuation aspect of the inventory problem and its specific application to the items of cost and market. In dealing with the question of cost and the interpretations which are placed on this concept the questions of average cost, last-in first-out, first-in first-out, standard cost and base or normal stock are discussed. The respective situations to which each of the different cost concepts apply are outlined and specific case examples are studied.

Throughout the treatises dealing with the valuation of inventories the effect of the different concepts both on income determination and balance sheet presentation is kept ever in the foreground. A special article is devoted to the question of inventory reserve plans based on the presence of profits arising from price changes and the relationship which these profits bear to the question of inventory valuation.

Part III covering the question of inventory taking outlines the procedure followed in the taking of inventories, stressing such relevant aspects as organization, use of tags, inventory cut off and correlation with the perpetual inventory records.

Part IV on inventory practice serves as a proper conclusion, consisting of two surveys made by the National Association of Cost Accountants on the question of inventories. It indicates fairly broadly the practical application of the questions raised in Parts I, II and III. The studies made were confined to raw and finished materials.

THE MANUFACTURE OF NYLON YARN

THE manufacture of nylon yarn will be a valuable addition to the already long list of useful products and materials produced by the chemical industry in Canada when the large plant now being erected at Kingston, Ontario, comes into production early in 1942.

Nylon, which has important uses as a war material as well as all the essential qualities to replace silk in the domestic picture, is derived from coal, air and water through the intermediate products of phenol and benzene, coal tar derivatives. By a complex chemical process, benzene is converted into a synthetic resin, nylon polymer. As the volume of nylon yarn to be manufactured at the outset in Canada does not justify production of polymer from basic materials, nylon polymer will be imported from the United States and manufacturing operations at Kingston will begin with the melting of the polymer.

In appearance nylon polymer is a thick, ivory-like substance which is chopped up into small chips, before being melted by heat to form a thick, viscous mass. This thick gummy liquid is then forced through tiny holes in a metal cup called a spinneret. It comes out in gauzy filaments which harden in cool air, in the same manner that a spider's web is spun. These tiny filaments are gathered together to form a strand of yarn.

This yarn is then put on "draw twisters" where it is drawn to four times its length. During this stretching process, a highly interesting phenomenon occurs. The molecules which have hitherto had a random arrangement, helter-skelter like straws in a haystack, take on an orderly formation becoming parallel to one another and being brought much closer together. It is this closely packed, parallel formation of the molecules which gives nylon its amazing strength and elasticity, the two qualities which make nylon of industrial value. Drawn nylon fibre of a given size has greater tensile strength than corresponding fibres of cotton, linen, wool, silk or rayon. In fact, nylon is $1\frac{1}{2}$ times stronger than silk and is superior in combined strength and elasticity.

After draw twisting, the process is very similar to other textile yarns, the yarn being twisted, sized, oiled and put

on cones or spools ready for shipping to the manufacturer of hosiery or textiles.

Owing to its versatile properties, nylon can be made into such things as sheer fabrics, velvets, lace and net; coated fabrics resembling leather; bristles for brushes, in which it will outwear ordinary hog's bristles many times; and water resistant gut for tennis racquets, fishing leaders, surgical sutures and a number of other uses.

The combination of strength and lightness makes nylon valuable for aviation. The fabric and shroud lines of a parachute made of silk weigh about 10 pounds, but the silk formerly used in Canada came from Japan and as this source of supply is no longer available it has been necessary to try to find a suitable substitute. A parachute of rayon or cotton would weigh between 20 and 30 pounds which, with an additional 13 pounds for harness, pack and fittings, would be an impossibly bulky load. Nylon, however, with only 75% the weight of silk has all the necessary qualities. For this reason the entire output of British Nylon Spinners is being devoted to war purposes and in the United States several hundred nylon parachutes are in use by the American flying services.

A large part of the production of the nylon plant at Kingston will be required by the Canadian government for war purposes.

TABLE OF EXCHANGE RATES

(Kindly supplied by The Canadian Bank of Commerce, Toronto)

	29th November 1941	*15th December 1941*
U.S. Dollars	10-11% P.	10-11% P.
Sterling	443-447	443-447
Australian Pounds	358½	358½
New Zealand Pounds	360	360
South African Pounds	443	443
British West Indian—Dollars	9270	9270
India—Rupees	3358	3358
Hong Kong—Dollars	2835	2835
Straits Settlements—Dollars	5251	5251
Sweden—Kronor	2637	2637
Switzerland—Francs	2569	2569

Note: The above currencies are expressed as follows: Pound currencies—Canadian cents per unit; Continental currencies and sundry British Empire—Canadian cents per 100 units.

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R. T. Cunningham, C.A., Winnipeg William Gray, C.A., Winnipeg Frederick Johnson, C.A., Winnipeg	The Institute of Chartered Accountants of Manitoba
H. G. Norman, C.A., Montreal Arthur E. Cox, F.C.A., Saint John	The New Brunswick Institute of Chartered Accountants
T. H. Johnson, C.A., Halifax G. E. Martin, C.A., Halifax	The Institute of Chartered Accountants of Nova Scotia
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T. H. Johnson, C.A., Halifax	The Institute of Chartered Accountants of Prince Edward Island
Wm. H. Campbell, C.A., Montreal C. F. Elderkin, C.A., Montreal Alfred Smibert, C.A., Montreal	The Society of Chartered Accountants of the Province of Quebec
C. P. DeRoche, C.A., Saskatoon M. Hesford, F.C.A., Swift Current G. G. Patrick, C.A., Saskatoon	The Institute of Chartered Accountants of Saskatchewan

Chairman of War Purposes Committee—Kris A. Mapp, F.C.A.
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Chairman, Committee on Accounting Research—D. McK. McClelland, F.C.A.
Chairman, Committee on Accounting Terminology—John Parton, F.C.A.

GENERAL NOTES

Our Contributors This Month

John Douglas Campbell, who writes on Industrial Managements' Fiscal Policy and has also in his charge the column "Glimpses of Current Accounting Literature," is a graduate in Commerce of Queen's University and a member of the Institute of Chartered Accountants of Ontario. He became a member of the staff of the School of Commerce and Administration of Queen's University, Kingston, in February 1939.

Philip Thomas Renouf Pugsley, whose article on Report Writing is published this month, is a member of the Society of Chartered Accountants of the Province of Quebec and a chartered accountant in Montreal. He is interested in educational work and is lecturer in the evening division of Sir George Williams College on Commercial Correspondence and Report Writing. He is also group leader in Effective Expression for the Chartered Accountants' Students' Society and for the Quebec Branch of The Chartered Institute of Secretaries.

Matters of Interest to Members

Herbert Anscomb, a member of the Institute of Chartered Accountants of British Columbia, has been named Minister of Mines and Trade and Industry in the new Provincial Cabinet of British Columbia, headed by Premier John Hart.

On Sunday, 14th December last, the congregation of Saint Matthias Anglican Church of Westmount, Province of Quebec, dedicated a window in the Church to the memory of the Late Honourable Gordon Wallace Scott, C.A., M.L.S. Canon Oliver referred to Mr. Scott's qualities of courage, leadership and sacrifice, and he stressed the fact that the memorial had been erected to one who had been a warden of that congregation, had loved his church and his fellowmen and had worked to promote goodwill in his province and throughout Canada.

Members of the profession will recall that Mr. Scott lost his life at sea through enemy action on Saturday, 14th December 1940, while proceeding to England on a special mission for the Canadian government.

Chartered Accountants in Civil Service Organize

Chartered accountants employed in the Dominion Civil Service have recently organized a professional group under the auspices of The Professional Institute of the Civil Service of Canada. The group has as its objects to enhance the usefulness of chartered accountants in the public service, to maintain high professional standards, to promote the welfare of its members and to develop fellowship within the group. To achieve these objects it is planned to form discussion groups, to inaugurate a course of instruction adapted to the particular needs of chartered accountants in the public service, and to hold social gatherings.

Although active membership is restricted to civil servants employed in regular departments of the Dominion government it is intended that certain of the activities of the group be open to all chartered accountants otherwise employed in the public service of Canada and others who may be interested in such matters. At present there are eighty-four members located as follows: Ottawa 35, Toronto 23, Winnipeg 11, Vancouver 15. It is proposed, in the near future, to canvass all chartered accountants in the civil service, but as there is not a complete list now available those interested should communicate with the Group Secretary, H. H. Milburn, C.A., c/o The Commissioner of Income Tax, No. 3 Temporary Building, Ottawa.

Aid to Britain

(*Editor's Note:* The following particulars on "Aid to Britain" and "Canadians and the War Effort" have been kindly supplied to us by the Director of Public Information, Ottawa.)

Canada, as Britain's ally, has sent more than 150,000 soldiers, sailors and airmen overseas. These troops are equipped and maintained at the Dominion's expense, with the exception of service craft for the Air Force, which are provided by Britain as part of her contribution to the Air Training Plan.

Most of the equipment and supplies already sent from Canada to Britain have been "lease-lent" by the Canadian people. In the present fiscal year Canada will send $1,500,000,000 worth of supplies to Britain. Canadians will provide all the money Britain will need to pay for these supplies.

Canada has put tankers and other ships at Britain's disposal. British ships are repaired and supplied in Canadian ports. Canada has taken charge of many prisoners of war. More than 6,000 British children have been given homes in Canada for the duration. Canadian homes are prepared to accommodate at least 100,000. Canadian citizens have voluntarily contributed more than $27,000,000 to war charities. A large part of this sum has been used to provide money and comforts for the victims of enemy bombing in Britain, for Canadian troops overseas, and to purchase planes and other war equipment. Blankets, clothing, food, mobile kitchens, hospitals, first-aid supplies, blood serum, ambulances and prisoners-of-war parcels have been provided.

Canadians and the War Effort

On 1st December, a general price ceiling was established in Canada. Wages and salaries are stabilized, and a wartime "cost-of-living" bonus is being paid to employees in the lower wage brackets. These regulations have been imposed to prevent inflation and to protect wage-earners against higher living costs. Price regulation will not be easy, but Canada has chosen the hard way because while "the price ceiling means hardship, inflation means ruin."

Canadians now pay three times as much in taxes of all kinds as they did before the war; five times as many pay five times as much in income taxes of all kinds. Taxes on goods and services have been increased and extended to cover a wide variety of commodities from soft drinks to travel fares. Business income is subject to a minimum tax of 40%, and 79½% of all "excess profits" are taken by the Government.

Since the outbreak of war Canadians have loaned the Government nearly $1,500,000,000 in return for war bonds and savings certificates.

This fiscal year the Canadian Government is spending about $2,350,000,000 for war—a sum which would be equivalent to an expenditure in the United States of about $35,000,000,000 for defence and lease-lend aid to Britain in a single year. Forty cents out of every dollar earned in Canada is required to support the war.

Supply of many essential materials is rigidly controlled. Among these are iron, steel, aluminum, nickel, zinc, copper, tin, silk and rubber. New models requiring new tooling are "taboo." Passenger automobile production in 1942 will be less than half what it was in 1940. Production of stoves, refrigerators, radios, vacuum cleaners and washing machines has been considerably reduced. Instalment purchases of a wide range of articles from furniture to engagement rings can be made only on very strict terms. Gasoline cannot be purchased on Sundays or between 7 p.m. and 7 a.m. on week days.

Canadians cannot get funds to travel in the United States except for urgent reasons, cannot hold foreign exchange, cannot export capital, and cannot import a great many "non-essential" goods normally bought from the United States. These regulations have been imposed because Canada needs every available United States dollar for war purchases.

Dominion-Provincial Taxation

As this month's issue went to press a statement on the conclusions of the meeting of the representatives of the nine provincial governments with the Department of Finance, Ottawa, on 19th December, had not been issued by Hon. J. L. Ilsley, Minister of Finance. It is understood, however, that all the provinces agreed to surrender their income and corporation taxing powers to the Dominion government during the war period.

Just as soon as particulars of the arrangements are announced, members of the Association and subscribers to the Dominion-Provincial Taxation service will be advised.

Customs and Excise Revenue

According to *The National Revenue Review* the customs and excise revenue collections of the Dominion government continue to exceed those of the previous year. For the eight months ending 30th November 1940 and 1941, these were as follows:

	1940	*1941*
Custom duties, net	$ 9,567,105	$13,297,540
Excise taxes, net	26,896,210	41,624,120
Excise duties, net	8,272,951	10,263,210
Sundry collections, net .	43,290	57,616
	$44,779,556	$65,242,486

or an increase for the 1941 period over that of 1940 of $20,462,930.

Income Tax Revenue

For the eight months ending 30th November 1941 the income tax collections of the Dominion government were $410,424,376, or an increase of $245,574,105 over the collections of the corresponding period of 1940.

Excess Profits Tax in Great Britain

The 100 per cent excess profits tax of Great Britain has been amended to the effect that 20% of the impost is now considered in the nature of a forced loan.

Photography Aids Accounting

The photographic department of the Powell Duffryn Associated Collieries Limited (England) came into existence for the purpose of photographing financial records. "There is a feeling of security in the knowledge that financial and other records upon which the proper functioning of commerce depends are not entirely at the mercy of the random bomb . . . that the records of the company, from which can be rebuilt the complete accounts, are preserved."

LEGAL DECISIONS

[EDITOR'S NOTE:—The following are brief summaries of recent decisions of the Canadian Courts as taken, by the kind permission of the Canada Law Book Company, from the *Dominion Law Reports*. In each case reference is made to the volume of the *Reports* where the full judgment may be found. It should be kept in mind that the decisions given may not in every case be final.]

Companies—Director causing sale of assets at undervalue for own benefit—Remedy of company

(re Crown Reserve Consolidated Mines)
Ontario Court of Appeal

Plaintiff company brought action alleging merely that defendant, when president and director of plaintiff, caused the transfer of its assets to the "A" company at an undervalue whereby he received a benefit, and claiming payment of all loss sustained by it therefrom. Judgment was rendered declaring plaintiff entitled to damages, to be assessed by the Master on the basis that defendant had received 1,000,000 shares in the "A" company from the transaction.

Held, the damages to which plaintiff was entitled on the cause of action set up was merely a return of the profit made by defendant from the impugned transaction, and the Master erred by fixing the damages at the amount of the deficiency in price received by plaintiff from the sale.—[1941] 3 D.L.R. 461.

Companies—Lease of premises necessary to business—Corporate seal

(re Kingston Motor Car Co., Limited)
Ontario High Court

A trading company is entitled to enforce a contract for the lease to it of premises necessary for the purposes of its trade although not executed under the corporate seal of the company.—[1941] 3 D.L.R. 778.

Companies—President of corporation—Right to preside at meetings

(re Fremont Canning Co. et al.)
Ontario Court of Appeal

Save in so far as the duties and powers of the president of a corporation are expressly limited by the charter or by-laws it is his duty and right to preside at all meetings, including shareholders' meetings.—[1941] 3 D.L.R. 97.

Companies—Shareholders' class action—Permission to sue in company's name refused

(re Levi et al. v. *MacDougall et al.)*

Supreme Court of Canada

An action by shareholders of a company suing on behalf of themselves and all other shareholders alleging that the company's president and a large shareholder fraudulently procured the company's property to be sold at a loss was dismissed by the trial Judge upon a motion made by defendants at the outset of the trial, without notice of intention to do so, on the ground that an allegation in the statement of claim, that an application by plaintiffs to the company for permission to bring the action in its name was refused, was insufficient to entitle them to sue in their own names, and following the admission of evidence produced by defendants' counsel that the individual defendants did not own a majority of the company's shares the trial Judge refused to afford plaintiffs' counsel an opportunity to amend by alleging that it would have been futile to apply for such permission to a shareholders' meeting. An appeal to the Court of Appeal was dismissed.

Held, assuming that the amendment was necessary, the action ought not to have been dismissed in the circumstances on the ground that the pleadings were insufficient, and the Court of Appeal ought to have allowed the plaintiff to amend.—[1941] 4 D.L.R. 340.

Contracts—Building contract—Cost plus basis—Damage within five years

(re Hill-Clark-Francis Limited v. *Northland Grocers)*

Supreme Court of Canada

A contract for the construction of a building on a cost plus basis in accordance with plans previously prepared for another building as modified, the undertaking being executed under the exclusive control of the contractor, is a contract of work by estimate and contract under C.C. art. 1683 and not a lease or hire of services: the fact that no price is stated in the contract and that there are no specifications

is immaterial. Where the building constructed pursuant to such contract suffers damage from faulty construction or from the nature of the soil within five years of its completion there exists a presumption of fault against the builder under C.C. art. 1688 which he can only rebut by proving that such damage was due to *force majeure*, act of God or fault of the owner or act of a third party. Time begins to run against an action for such damage not from the completion of the building but from the time the loss is apparent. —[1941] 4 D.L.R. 314.

Taxes—Allocation of corporation's assessments to separate schools—Determination of proportion

(re Ford Motor Co. et al.)

Judicial Committee of Privy Council

Upon the proper construction of s. 66 of the *Separate Schools Act*, R.S.O. 1937, c. 362, the effect of s-s. (3) thereof, which enacts that the portion of a corporation's assessments allocated by it for separate school purposes shall not bear a greater proportion to the whole of its assessments than the amount of its shares held by Roman Catholics bears to the whole of its shares, is that upon an appeal by a ratepayer affected by the corporation's notice of allocation and the assessment made thereunder the onus is upon the corporation to establish that the proportion of its assessments so allocated does not exceed the permitted proportion, and not upon the attacking ratepayer to establish that it does exceed such permitted proportion. Where the corporation fails to satisfy such onus its notice of allocation will be set aside and all its assessments assessed for public school purposes. The assessment appeal tribunals have no power to amend an assessment declared invalid in such circumstances by reference to the true proportion of the corporation's Roman Catholic shareholders when ascertained; the company would have to make a fresh apportionment and give a fresh notice, assuming there was time to do so for the year of assessment in dispute.—[1941] 3 D.L.R. 721.

Taxes—Company's entire income derived from shares in subsidiaries—Whether offices occupied for purposes of business

(Russell Industries Limited v. *City of Toronto)*

Ontario Court of Appeal

Appellant company was the chief share-owner of three manufacturing companies, its entire income being derived from the dividends thereon together with the proceeds of investments in certain other companies. Appellant contended that it was liable to business assessment under s. 8 of the *Assessment Act*, R.S.O. 1937, c. 272, and not to income assessment under s. 9(1)(b), on the grounds (1) that at its offices it directed the business of its subsidiaries and therefore carried on business as a manufacturer, or (2) that it there carried on the management of its own affairs, which was a "business" within the meaning of s. 8. The Municipal Board rejected both contentions, and added in respect of the second, that in any event the company's income was not received by reason of that business.

Held, these were questions of fact, and no appeal lay to the Court of Appeal under s. 84(6).—[1941] 3 D.L.R. 361.

PROVINCIAL NEWS

ALBERTA

At a meeting of the Calgary Chartered Accountants' Club held 20th November at the Renfrew Club, Alan Dixon, John Hardie and Alan Humphries, successful candidates in the June examinations, were presented with certificates of membership in the Institute of Chartered Accountants of Alberta by Kenneth Morrison. Mr. Morrison also presented Mr. Hardie with a prize from the Alberta Institute for obtaining the highest marks of the Alberta candidates in the examinations. At a previous meeting Mr. Hardie was presented with a medal and a prize for obtaining the highest marks in the Dominion for the same examinations, which are now uniform for all provinces.

Mervin Graves, President of the Alberta Institute, introduced Major Johnson of the First Calgary Highlanders, now home from England on furlough, who gave the Club

an informal talk on the Canadian army in England. Major Johnson emphasized the importance of sending mail and parcels to the men and suggested that as far as possible letters should be cheerful and designed to build up the morale of the men. "Smokes," he said, "are most welcome at all times."

Major Johnson also spoke of Captain C. V. Corbet, a member of the Alberta Institute, who is with the Highlanders in England.

QUEBEC

QUEBEC CITY

The following officers were elected at a recent meeting of the Quebec City Committee of The Society of Chartered Accountants of the Province of Quebec: president, A. E. Beauvais; vice-president, C. A. Fontaine; immediate past president, J. A. Towner; directors, Guy Fortier, G. H. Boulet, Paul Bruneau and J. F. O'Neil; secretary, R. Courtois.

PERSONALS

A. E. Crickmay, a member of the Institute of Chartered Accountants of British Columbia, announces the opening of an office at 421 Hall Building, Vancouver, British Columbia for the practice of his profession.

Charles Greer & Company, chartered accountants, announce that their office address is now 814 Excelsior Life Building, 36 Toronto Street, Toronto.

Richter, Usher & Co., 460 St. Catherine St. West, Montreal, announce the admission to partnership of S. S. Stein. The firm will continue to practise under the present name of Richter, Usher & Co., chartered accountants.

B. E. Stokes and R. D. Peers, members of the Institute of Chartered Accountants of British Columbia, announce that they have formed a partnership for the practice of their profession at 512-514 Stock Exchange Building, Vancouver, under the firm name of Stokes, Peers & Company, chartered accountants.

STUDENTS' DEPARTMENT

R. G. H. SMAILS, C.A., Editor

NOTES AND COMMENT

In the discussion of charges of negligence directed at auditors the thought has occasionally been expressed (by judges as well as laymen) that the audit was "*only* (or *merely*) the statutory audit." We wonder with what type of audit the statutory audit was being compared that it should deserve this rather derogatory term, "only" or "merely." The companies acts require the auditor to express an opinion on the correctness of the annual statements and they place on him the responsibility of deciding, in each engagement, the nature and amount of work which he must do in order to form an opinion. If he expresses an opinion without having reasonable grounds for holding that opinion he is presumably guilty of either negligence or fraud depending on the degree of laxity. As Lindley, L.J., said in his judgment in the London and General Bank case: "He [the auditor] must be honest—that is, he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true." This would seem to make the statutory audit a quite severe rather than a relatively slight responsibility and indeed it is difficult to read the full text of the judgment in the City Equitable Fire Insurance case without being impressed by the amount of skill and care which the auditor is expected to exhibit and especially by Mr. Justice Romer's observation that "if in the course of these long and arduous duties [the auditor] has in even one instance fallen short of the strict duty of an auditor, he cannot, I apprehend, be excused merely because in general he displayed the highest degree of care and skill." The only type of examination commonly encountered which places on the auditor a greater measure of responsibility than the statutory audit seems to be the special investigation of the affairs of a company following exposure of irregularities which were not or could not be detected by the methods available to the statutory auditor. In the conduct of such an examination the investigator has information and means of information not available prior to the disclosure.

Professor Finney's latest book "General Accounting" which is reviewed elsewhere in this issue has been written primarily for those who do not intend to make a profession of accountancy. In spite of this we believe that many professional accountants and students will find it refreshing reading. Certainly its treatment of such subjects as the consolidated balance sheet and the application of funds statement, by its brevity and clarity, conveys more information to the reader than many of the extended disquisitions which we have read.

* * *

STUDENTS' ASSOCIATION NOTES

PROVINCE OF QUEBEC

The Annual Smoker of the Chartered Accountants' Students' Society of the Province of Quebec was held at the Windsor Hotel on Friday evening, 12th December, and judging by comments heard was considered a great success.

The program again included the Atterberry Players who very amusingly characterized the trials of the auditor's daughter with her secret reserves, to the eventual triumph of the C.A. over the villain.

A chorus of three dancing girls was present and, together with Cammie Grant's stories told in his seven dialects, rounded out an evening which everyone enjoyed very much.

It is felt that functions such as these do much to foster a spirit of goodwill amongst the student body, as they offer the members one of the few opportunities to meet their confrères.

Hugh Savage, Ralph Linton and John Weir were in charge of the entire program and should be congratulated on the excellent standard of entertainment provided.

Christmas gifts of cigarettes have been sent to twenty-two students on Active Service Overseas.

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by practising members of the several provincial Institutes and represent the personal views and opinions of those members. They are designed not as models for submission to the examiner but rather as such discussion and explanation of the problem as will make its study of benefit to the student. Discussion of solutions presented is cordially invited.

PROBLEM I

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

INTERMEDIATE EXAMINATION, DECEMBER 1940

Accounting II, Question 4 (15 marks)

From the following trial balances prepare a consolidated working sheet:

Debits:	Company A	Company B	Company C
Investment in Company B:			
Common stock—1,600 shares	$160,000		
Preferred stock—6% non-cumulative redeemable at par, 800 shares	80,000		
Investment in Company C:			
Common stock—1,200 shares	120,000		
Preferred stock—cumulative, 1,600 shares	160,000		
Account receivable—Company B	20,000		
Other assets	70,000	$420,000	$600,000
Deficit		50,000	
Total	$610,000	$470,000	$600,000

Credits:	Company A	Company B	Company C
Reserve against investment in Company C	$ 40,000		
Account payable—Company A		$ 20,000	
Accounts payable—Minority shareholders		50,000	
Capital stock consisting of fully paid shares of $100 each:			
Common	200,000	200,000	$200,000
Preferred—6% non-cum.		200,000	
Preferred—6% cumulative	300,000		200,000
Earned surplus	70,000		200,000
Total	$610,000	$470,000	$600,000

Shares of the subsidiaries were purchased on the dates when the subsidiaries were organized and are stated at cost.

Dividends on the preferred shares, none of which have been declared, have not been paid for the following number of years:

Company A—2 years
Company B—5 years
Company C—5 years.

SOLUTION

COMPANY A AND ITS SUBSIDIARIES — COMPANY B AND COMPANY C

CONSOLIDATED WORKING SHEET — (date)

Item	Company A Dr.	Company A Cr.	Company B Dr.	Company B Cr.	Company C Dr.	Company C Cr.	Adjustments, etc. Dr.	Adjustments, etc. Cr.	Assets	Capital & Surplus	Minority Interests
Investment in Company B											
Common stock (80%)	$160,000							(1) $160,000			
Preferred stock (40%)	80,000							(2) 80,000			
Investment in Company C											
Common stock (60%)	120,000							(3) 120,000			
Preferred stock (50%)	160,000							(4) 160,000			
Reserve against investment in Company B		$ 40,000								$ 40,000	
Accounts receivable— Company B	20,000							(5) 20,000			
Other Assets	70,000		$420,000		$600,000				$1,090,000		
Accounts payable—Company A				$ 20,000			(5) $ 20,000				
Accounts payable— Minority shareholders				50,000							50,000
Capital stock											
Company A											
Common		200,000								200,000	
Preferred		300,000								300,000	
Company B											
Common				200,000			(1) 160,000				40,000
Preferred				200,000			(2) 80,000				120,000
Company C											
Common						$200,000	(3) 120,000				80,000
Preferred						200,000	(4) 160,000				40,000
Surplus—Company A		70,000								70,000	
Deficit—Company B			50,000							*40,000	*10,000
Surplus—Company C						200,000				48,000	12,000
										84,000	56,000
TOTALS	$610,000	$610,000	$470,000	$470,000	$600,000	$600,000	$540,000	$540,000	$1,090,000	$702,000	$388,000

NOTE:—The item "Accounts payable—Minority shareholders" would be set out in the final consolidated balance sheet as an account payable and not as part of the "Minority Interests." It presumably bears the same relation to minority interests as dividends payable bear to capital and surplus.

PROBLEM II

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

FINAL EXAMINATION, JUNE 1941

Accounting I, Question 1 (20 marks)

The A. B. Company Limited manufactures an accessory for the automotive trade. All articles made are uniform in construction and value. Its inventory of 1st January consisting of raw materials and finished goods was valued at $237,000. The company's premises were broken into on the evening of 1st October 1940 and the manager filed the following claim for goods taken:

600 completed articles at $40 each	$24,000
Raw materials	3,000
Total claim	$27,000

You are asked to make such investigation into the affairs of the company as may be necessary to determine the correctness of the claim. No details of the inventory as of 1st January are available, but you ascertain that sales are uniformly made at 50% over cost of materials and labour. A tabulation of the sales invoices disclosed the fact that 9,000 articles were sold in the period from 1st January to 1st October. Factory production orders show that 6,000 articles were made during the same period. Factory records show that only two kinds of raw materials are used—metal sheets and leather, and that 40,000 metal sheets and 10,000 square yards of leather were used in the production of the articles in the period from 1st January to 1st October. Purchase invoices for the same period show that 37,500 metal sheets at $2.00 each and 10,000 square yards of leather at $4.00 per square yard, were bought. Wages were paid on a piece work basis and amounted to 70% of the value of the raw materials used. On the morning of 2nd October 1940 the inventory handed to you consisted of:

2,500 Finished articles at $40	$100,000
Metal at cost	25,000
Leather at cost	20,000
	$145,000

Having completed your investigation you are required to:

(1) Prepare a statement showing cost of finished article

(2) Prepare a statement proving the correctness or otherwise of the claim filed

(3) Prepare a statement showing, as of 1st January 1940:

- (a) Number of finished articles and their value
- (b) Number of metal sheets and value
- (c) Number of square yards of leather and value.

SOLUTION

(1) *Statement of Manufacturing Costs, 1st January to 1st October 1940*

Materials used in manufacturing:	
40,000 metal sheets at $2 each	$ 80,000
10,000 square yards of leather at $4	40,000
Total value of material used to produce 6,000 articles	$120,000

Therefore, each article cost $20.00 for material
Wages paid are 70% of the cost of materials = $14
Total cost in labor and materials per article is therefore $34

(2) *Statement of Values to be Accounted For, 1st January to 2nd October 1940.*

Values to be accounted for		*Values accounted for*		
Opening inventory (details of which are lost)	$237,000	Sales at cost price		$306,000
Purchases:		Closing inventory:		
Metal	75,000	2,500 completed articles at $34 each	$85,000	
Leather	40,000	Metal at cost	25,000	
		Leather at cost	20,000	130,000
Wages:				
6,000 articles manufactured at labour cost of $14 each	84,000			
Total value to be accounted for	$436,000	All values fully accounted for		$436,000

There was therefore no shortage in inventory on 2nd October 1940.

(3) (a), (b) and (c)

To determine quantities on hand 1st January 1940, it is necessary to proceed from the simple formula that quantities on hand at the beginning plus those bought or made, must equal quantities sold or used plus those on hand at the end. Thus:

Given	*Number of Finished Articles*	*Square yards of leather*	*Sheets of metal*
On hand 2nd October 1940	2,500	5,000	12,500
Sold or used	9,000	10,000	40,000
	11,500	15,000	52,500
Bought or made	6,000	10,000	37,500
Deduced			
On hand 1st January	5,500	5,000	15,000

Inventory, 1st January 1940

5,500 finished articles	at $34	$187,000
5,000 square yards leather	at 4	20,000
15,000 metal sheets	at 2	30,000
		$237,000

PROBLEM III

THE PROVINCIAL INSTITUTES OF CHARTERED ACCOUNTANTS

FINAL EXAMINATION, JUNE 1941

Accounting I, Question 3 (20 marks)

The Canadian Manufacturing Company Limited at the end of the year 1939 adopted a practice of valuing its inventory of goods on hand at selling price less 20% for gross profit to reduce the inventory to the basis of manufacturing cost. The inventories taken on the above basis amounted at 31st December 1939 to $221,321.60, and at 31st December 1940 to $210,314.24. In the course of investigating the matter, you find that sales for the year 1940 amounted to $666,759.20 and that manufacturing cost of goods made during that year amounted to $489,750.00. Prior to 31st December 1939, the inventories had been taken at actual cost. All sales are made from manufactured goods.

Assuming that the rate of actual gross profit did not vary in respect of years 1939 and 1940, you are asked to prepare information showing:

(1) Value of inventories as at 31st December 1939 and 1940 with particulars of any changes ascertained by you.

(2) The effect, if any, on the profits as previously determined in respect of the years 1939 and 1940.

(3) Any adjustments which should be made in the income tax returns for years 1939 and 1940, assuming that company rates are 18% for the year 1939 and 30% for 1940.

SOLUTION

(1) The cost of goods manufactured is unknown but the selling price of three of the factors, i.e., opening inventory, sales and closing inventory is easily arrived at and this gives us our cue.

Statement of Merchandise in Terms of Selling Prices

1940		1940		
1st January		31st December		
Inventory at selling price less 20%	$221,321.60	Sales at selling price		$666,759.20
Restore the 20% taken off selling price to reduce to estimated cost	55,330.40	31st December		
Opening inventory at selling price before adjusting	276,652.00	Inventory at selling price less 20%	$210,314.24	
Selling price of factory output (manufactured goods) .	653,000.00	Restore the 20% taken off selling price to reduce to estimated cost	52,578.56	262,892.80
Opening inventory and factory output at selling prices ..	$929,652.00	Sales and closing inventory at selling prices		$929,652.00

The problem gives the cost of goods made during the year as	$489,750.00
Our calculations above show the selling price of the goods made during the year to be	653,000.00
Showing an actual profit of	$163,250.00

If $163,250 is the profit on goods having a selling price of $653,000 what percentage of the selling price is profit?

$$\$163{,}250 \times \frac{100}{\$653{,}000} = 25\%$$

Therefore instead of deducting 20% from the inventories to bring them down to cost the deduction should have been made at the rate of 25%.

Statement Showing Corrected Inventories

Inventory 1st January, 1940 after deducting 20% from selling price	$221,321.60
Restore to selling price	55,330.40
Actual selling price of inventory	276,652.00
Deduct 25% to bring down to actual cost	69,163.00
Inventory at 1st January, at cost price	$207,489.00
Inventory 31st December 1940 after deducting 20 from selling price	$210,314.24
Restore to selling price	52,578.56
Actual selling price of inventory	262,892.80
Deduct 25% to bring down to actual cost	65,723.20
Inventory 31st December at cost price	$197,169.60

(2) Since we are informed that correct inventory valuations were made prior to 31st December 1939 and since the 31st December 1939 inventory was stated to be $221,321.60 whereas the inventory at actual cost amounted to $207,489.00, it follows that the inventory was overstated by $13,832.60. If this asset were overstated by that amount, the profit for 1939 was overstated by the same amount.

The 31st December 1939 inventory was overstated by	$ 13,832.60
The 31st December 1940 inventory was overstated by $210,314.24 — $197,169.60	13,144.64
Difference	$ 687.96

Reducing the opening inventory has the effect of increasing the profit whereas a reduction in the closing inventory has the effect of reducing the profit.

Therefore, the reduction in the opening inventory amounting to .... $ 13,832.60
will increase profit

The reduction in the closing inventory amounting to will reduce profit	13,144.64
Leaving the sum of	$ 687.96
as a net increase in the 1940 profits over the profits as originally stated.	
(3) Profits for 1939 were overstated by	$ 13,832.60
Income tax at 18% = ...	$ 2,489.87
Therefore the tax in respect of 1939 was overstated by this amount.	
Profits for 1940 were understated by	$ 687.96
Income tax at 30% = ...	$ 206.39

The tax in respect of 1940 was understated by this amount.